No. 96-1570-CFX Title: NYNEX Corporation, et al., Petitioners
v.
Discon, Incorporated

Docketed: April 4, 1997 Court: United States Court of Appeals for the Second Circuit

Entry	Date	Proceedings and Orders
	Apr 3 1997	Petition for writ of certiorari filed. (Response due May 4, 1997)
	Apr 10 1997	Motion of Association of the Bar of the City of New York for leave to file a brief as amicus curiae filed.
	May 5 1997	Motion of Consumer Electronics Manufacturers Association for leave to file a brief as amicus curiae filed.
	May 5 1997	Brief of respondent Discon Incorporated in opposition filed.
	May 15 1997	Reply brief of petitioners NYNEX Corporation, et al. filed.
	Jun 25 1997	DISTRIBUTED. September 29, 1997
	Oct 6 1997	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
	Feb 19 1998	Brief amici curiae of United States and the Federal Trade Commission filed.
	Feb 25 1998	REDISTRIBUTED. March 20, 1998
	Mar 3 1998	Supplemental brief of petitioners filed.
	Mar 23 1998	Motion of Association of the Bar of the City of New York for leave to file a brief as amicus curiae GRANTED.
	Mar 23 1998	Motion of Consumer Electronics Manufacturers Association for leave to file a brief as amicus curiae GRANTED.
	Mar 23 1998	Petition GRANTED. SET FOR ARGUMENT October 5, 1998. **********
	Mar 27 1998	Order extending time to file brief of petitioner on the merits until June 1, 1998.
	May 29 1998	Brief amicus curiae of Business Roundtable filed.
	Jun 1 1998	Joint appendix filed.
	Jun 1 1998	Brief of petitioners NYNEX Corporation, et al. filed.
	Jun 1 1998	Brief amicus curiae of GTE Corporation filed.
	Jun 1 1998	Brief amicus curiae of American Automobile Manufacturers Association filed.
	Jun 1 1998	Brief amicus curiae of Association of the Bar of The City of New York filed.
	Jun 16 1998	Order extending time to file brief of respondent on the merits until July 20, 1998.
	Jun 17 1998	Brief amici curiae of United States and the Federal Trade Commission filed.
	Jun 22 1998	Brief amici curiae of Law Professors filed.
	Jul 20 1998	Brief of respondent Discon Incorporated filed.
	Jul 22 1998	Motion of Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
	Jul 31 1998	CIRCULATED.
	Jul 31 1998	Record filed.
	Aug 14 1998	Reply brief of petitioners NYNEX Corporation, et al. filed.
	Sep 9 1998	Motion of Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument

No. 96-1570-CFX

Entry	Date	Proceedings and Orders
		GRANTED. to be divided as follows: petitioner - 25 minutes; respondent - 25 minutes; the Solicitor General - 10 minutes.
	Oct 5 1998	ARGUED.

FILED

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OFFICE OF THE CLERK

No. 96-____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES COMPANY, and NEW YORK TELEPHONE COMPANY,

Petitioners,

v.

DISCON INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, New York 10017
(212) 450-4192

EDWARD S. BLOOMBERG
KEVIN J. ENGLISH
PHILLIPS, LYTLE, HITCHCOCK, BLAINE & HUBER
One Marine Midland Center
Buffalo, New York 14203
(716) 847-8400

Counsel for Petitioners

April 3, 1997

87 pp

Questions Presented

When a Purchaser agrees to buy from Supplier A rather than Supplier B, and there is no issue of any horizontal restraints or vertical price restraints:

1. May the agreement between Purchaser and Supplier A be characterized as a group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?

2. May the agreement between Purchaser and Supplier A be characterized as a conspiracy to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2?

Parties to the Proceeding Below

The parties to the proceeding in the Court of Appeals were respondent Discon Incorporated, as plaintiff-appellant; petitioners NYNEX Corporation, NYNEX Materiel Enterprises Company, and New York Telephone Company, as defendants-appellees; and two defendants-appellees who are no longer parties to the case, Robert J. Eckenrode and Bernard O'Reilly. Mr. Eckenrode and Mr. O'Reilly were not named as defendants in the Sherman Act § 1 and § 2 claims, and all of the claims in which they were named as defendants have been dismissed.

Pursuant to Supreme Court Rule 29.6, petitioners state that petitioner NYNEX Corporation has no parent company, and that it is the direct or indirect parent company of petitioners New York Telephone Company and NYNEX Materiel Enterprises Company. Petitioners New York Telephone Company and NYNEX Materiel Enterprises Company have no nonwholly owned subsidiaries. Petitioner NYNEX Corporation has direct and indirect interests in the following nonwholly owned entities:

Associated Venture Investors III, L.P.
BANX Partnership
Bayan Telecommunications Holding Corporation
Bell Atlantic NYNEX Mobile, Inc.
Bell Communications Research, Inc.
Cable Programme Partners-1 Limited Partnership
CAI Wireless Systems, Inc.
Cellco Partnership d/b/a Bell Atlantic NYNEX Mobile
Chartwell Investors L.P.
FLAG Limited
Gibraltar NYNEX Communications Limited
Kipling Associates L.L.C.

London Interconnect Limited
Mediatel spol. s.r.o.
New York SMSA Limited Partnership
North CableComms L.L.C.
Nusantara Communications Consortium
NYNEX CableComms Group Inc.
NYNEX CableComms Group PLC
NYNEX International (Asia) Ltd
NYNEX International Media Company
NYNEX Master Lease Partners
NYNEX Worldwide Directories Company
Polskie Ksiazki Telefoniczne
PrimeCo Personal Communications, L.P.
P.T. Excelcomindo Pratama
Roxbury Corners Limited Partnership
South CableComms L.L.C.
STET Hellas Telecommunications S.A.
TelecomAsia Corporation Public Company Limited
TELE-TV
TELE-TV Media, L.P.
TELE-TV Systems, L.P.
The Messaging Alliance, L.P.
The Parliamentary Channel Limited
TOMCOM, L.P.
Tuka Cellular Tokai K.K.
Tuka Cellular Tokyo K.K.
Tuka Phone Kansai K.K.
Viacom, Inc.
Winston Investors L.L.C.
Zlate Stranky Mediatel spol. s.r.o.

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IN THE

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OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES COMPANY, and NEW YORK TELEPHONE COMPANY,

Petitioners,

v.

DISCON INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit (Chief Judge Newman and Circuit Judges Oakes and Parker), which reversed the dismissal of plaintiff's amended complaint by the United States District Court for the Western District of New York (Honorable Richard J. Arcara, U.S.D.J.). The Second Circuit reversed on the basis of two novel theories under Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, which are in conflict with decisions of other circuits and of this Court.

For the reasons set forth below, petitioners respectfully suggest that the Court should grant a writ of certiorari and summarily reverse the judgment of the court below on the ground that it is contrary to this Court's decision in *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717

(1988). In the alternative, the Court should grant a writ of certiorari and set the case down for briefing and argument. The court below acknowledged that its decision created a conflict among circuits as to whether a single firm's decision to purchase from one supplier rather than another can properly be characterized as a "boycott" for antitrust purposes. The decision below, which in fact conflicts with decisions from more circuits than the court below recognized, will lead to significant litigation and business uncertainty unless it is reviewed and reversed by this Court.

Opinions Below

The opinion of the Court of Appeals is reported at 93 F.3d 1055, and is set forth in the Appendix (1a-20a). The order of the Court of Appeals denying rehearing and rehearing in banc is not reported, and is set forth in the Appendix (54a-55a). The opinion of the District Court is not reported, and is set forth in the Appendix (21a-53a).

Jurisdiction

The judgment of the Court of Appeals was entered on August 26, 1996. Petitioners' timely petition for rehearing and suggestion for rehearing in banc was denied by the Court of Appeals on January 7, 1997 (54a-55a). The jurisdiction of this Court to review the judgment of the Court of Appeals by writ of certiorari is conferred by 28 U.S.C. §§ 1254(1), 2101(c).

Statutes Involved

Section 1 of the Sherman Act, 15 U.S.C. § 1, reads as follows:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court."

Section 2 of the Sherman Act, 15 U.S.C. § 2, reads as follows:

> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court."

Statement of the Case

A. Background

Plaintiff Discon Incorporated ("Discon") was a supplier of equipment removal services (3a). Defendant NYNEX Corporation ("NYNEX") owned defendant New York Telephone Company ("NYT"), The New England Telephone and Telegraph Company, and other subsidiaries, including defendant NYNEX Materiel Enterprises Company ("MECo"), which served as a purchasing agent for the NYNEX companies (3a-4a).

During the mid-1980s, NYT purchased removal services, either directly or through MECo, from a number of suppliers, including Discon and AT&T Technologies, Inc. (''AT&T Technologies''), an unrelated company which is not named as a defendant herein (4a & n.2, 6a). After July 1985 MECo stopped using Discon, and after May 1986 NYT did so as well (*see* JA128-JA129).[1] Discon alleged that the NYNEX companies transferred their business to AT&T Technologies as part of a scheme to defraud NYT's ratepayers by inflating the prices the NYNEX companies paid for removal services (5a-6a).

B. The Decision of the District Court

Discon's original complaint alleged seven federal antitrust and RICO claims, as well as nine state law claims (JA12-JA61). Federal jurisdiction was based on 15 U.S.C. § 15 and 18 U.S.C. § 1964 (JA14, JA114). The District Court dismissed all of the claims in Discon's original complaint, but granted leave to replead (JA67-JA108).

Discon's amended complaint alleged seven federal antitrust and RICO claims and six state law claims (JA109-JA162). The District Court dismissed the federal claims with prejudice and the state law claims without prejudice (21a-53a).

The District Court held that Discon's Sherman Act § 1 claim should be dismissed, among other reasons, because when a buyer purchases from one supplier rather than another, ''the fact that an agreement between the buyer and the new supplier is necessarily involved does not make it an illegal conspiracy'' (29a, *quoting Nifty Foods Corp.* v. *Great Atl. & Pac. Tea Co.*, 614 F.2d 832, 841 (2d Cir. 1980)).

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1. ''JA'' citations are to the Joint Appendix in the Court of Appeals.

Discon argued that it had alleged a horizontal conspiracy between AT&T Technologies and the NYNEX companies in violation of Sherman Act § 1, but the District Court held that the fact that the NYNEX companies were purchasers of removal services and not competitors of AT&T Technologies in rendering such services was fatal to this theory (28a-29a).

Discon also argued that it had alleged a vertical price-fixing conspiracy in violation of Sherman Act § 1, but the District Court held that Discon had failed to allege an agreement to comply with fixed prices (30a).

The District Court dismissed Discon's Sherman Act § 2 claims, among other reasons, because the NYNEX companies neither provided nor sought to provide removal services, and could not monopolize a market in which they did not participate (32a-38a).

Discon appealed to the Court of Appeals from the dismissal of its federal claims (JA330). Discon did not appeal the dismissal without prejudice of its state law claims, but instead commenced a state court action against NYNEX and NYT.

C. The Decision of the Court of Appeals

The Court of Appeals held that the District Court had properly dismissed Discon's RICO claims (15a-20a), and that the District Court had correctly dismissed Discon's antitrust claims as Discon had articulated them (6a-10a, 13a-14a).

The Court of Appeals rejected Discon's claim of a horizontal conspiracy to restrain trade between AT&T Technologies and the NYNEX companies, holding that under *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 771 (1984), the NYNEX companies must be regarded for antitrust purposes as a single entity purchasing removal services from

AT&T Technologies and others (8a-10a). The Court of Appeals also rejected Discon's claim of vertical price-fixing (10a n.5).

The Court of Appeals went on to say, however, that "we believe that Discon may be able to prevail under a different legal theory" (10a). Although Discon had not cited *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the Court of Appeals held that the group boycott doctrine of *Klor's* could be "extended . . . to the situation where only a single retailer and a single manufacturer conspire" (11a). The Court of Appeals acknowledged that "such arrangements will often resemble exclusive distributorship agreements, which are generally considered permissible under the rule of reason," and stated that "*in general*, two-firm vertical combinations will be scrutinized as exclusive distributorship controversies, rather than as group boycotts" (12a; emphasis in original). However, the Court of Appeals held that the present case could be characterized as a group boycott because, it said, "no . . . pro-competitive rationale appears on the face of the complaint" (12a).

The Court of Appeals affirmed the dismissal of Discon's claims of monopolization and attempt to monopolize under Sherman Act § 2, holding that "it is axiomatic that a firm cannot monopolize a market in which it does not compete" and that there was no dangerous probability of success because the NYNEX companies did not compete in the market for removal services and never sought to do so (14a).

Discon's conspiracy to monopolize claim, as pleaded, was based on the theory that the NYNEX companies joined in a conspiracy with AT&T Technologies and others with specific intent to monopolize the market for removal services (JA150). This claim was subject to dismissal for the same

reasons as Discon's monopolization and attempt to monopolize claims.

Once again, the Court of Appeals upheld Discon's conspiracy to monopolize claim on a theory not pleaded by Discon. The Court of Appeals held that a purchaser "may be liable for conspiracy to monopolize where it agrees with [a supplier] to assist [the supplier] in its attempt to monopolize the relevant market" (14a).

REASONS FOR GRANTING THE WRIT

I. The Court of Appeals Created a Conflict Among Circuits, and a Direct Conflict With the *Business Electronics* Decision of This Court, by Extending the Group Boycott Rule of *Klor's* to a Two-Firm Supplier-Purchaser Situation.

A key distinction under Section 1 of the Sherman Act is the distinction between horizontal and vertical agreements. A horizontal agreement is an agreement between competitors, and a vertical agreement is an agreement between firms at different levels of distribution. *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 730 (1988). This Court has held that a vertical agreement is *per se* illegal only if it restricts the buyer's freedom to set its own prices. *Id.* at 720, 735-36.

The distinction between horizontal and vertical agreements plays a critical role in safeguarding the freedom of a buyer to replace one supplier with another (and *vice versa*), which is the essence of a free competitive economy. In keeping with this distinction, the courts have held that "the decision of the seller to transfer his business from A to B is valid even though B may have solicited the transfer and even though the seller and B may have agreed before the seller terminates his

dealings with A."[2] This rule flows from the fact that the antitrust laws "were enacted for the protection of *competition*, not *competitors*," *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487-88 (1977), *quoting Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962) (emphasis in original), and the fact that the substitution of one buyer or seller for another does not alter the nature of competition. This rule also prevents the antitrust laws from being misused as a means of obtaining judicial review of businesses' decisions to buy from one supplier rather than another *Fastway Constr. Corp.* v. *City of New York*, 762 F.2d 243, 251 (2d Cir. 1985).

In the present case, the Court of Appeals correctly held that the alleged agreement between the NYNEX companies and

2. *Nifty Foods Corp.* v. *Great Atl. & Pac. Tea Co.*, 614 F.2d 832, 841 n.14 (2d Cir. 1980), *quoting Joseph E. Seagram & Sons, Inc.* v. *Hawaiian Oke & Liquors, Ltd.*, 416 F.2d 71, 78 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970). *See also, e.g., Coastal Transfer Co.* v. *Toyota Motor Sales, U.S.A.*, 833 F.2d 208, 211 (9th Cir. 1987) (no antitrust claim is presented by "the recurrent case of the jilted . . . supplier who loses a manufacturer's franchise and accuses the manufacturer and the new suitor of attempting to monopolize something"); *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532, 539 (7th Cir. 1986) ("There is no anticompetitive effect when a buyer simply terminates an at-will contract with one supplier and enters into a similar contract with another supplier."); *Dunn & Mavis, Inc.* v. *Nu-Car Driveaway, Inc.*, 691 F.2d 241, 245 (6th Cir. 1982) ("Chrysler's substitution of one auto transport company for another at its Warren plant does not limit competition in any substantial sense."); *Quality Mercury, Inc.* v. *Ford Motor Co.*, 542 F.2d 466, 469 (8th Cir. 1976) ("[A] manufacturer may terminate a distributorship held by one party and transfer it to another without violating the Sherman Act."); *Burdett Sound, Inc.* v. *Altec Corp.*, 515 F.2d 1245, 1249 (5th Cir. 1975) ("Lest any other former distributors succumb to the temptation of treble damages, we reiterate that it is simply not an antitrust violation for a manufacturer to contract with a new distributor, and as a consequence, to terminate his relationship with a former distributor, even if the effect of the new contract is to seriously damage the former distributor's business.").

AT&T Technologies was not a horizontal agreement, because the NYNEX companies did not compete with AT&T Technologies in the rendering of removal services (8a-10a). The Court of Appeals also correctly rejected Discon's claim of vertical price-fixing (10a n.5).

However, the Court of Appeals then reached out to apply *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), a case that had not been cited by Discon. *Klor's* dealt with a horizontal group boycott, in which competing manufacturers and wholesalers allegedly conspired not to deal with a particular customer. The Court of Appeals held that *Klor's* could be applied to a two-firm supplier-purchaser situation like that involved in the present case, even though such a situation involves no horizontal conspiracy among competing firms (11a-12a). The court below cited two cases from other circuits that it believed had extended *Klor's* in this way (11a). It acknowledged, however, that the Eleventh Circuit had refused to extend *Klor's* in this manner (11a-12a). The court below sought to support its extension of *Klor's* by asserting that a vertical agreement may be characterized as a horizontal restraint of trade "if the agreement seeks to disadvantage the direct competitor . . . of one of the conspiring firms" (11a).

In actuality, neither of the cases cited by the Court of Appeals extended *Klor's* to a two-firm supplier-purchaser situation.[3] At least nine other circuits, including the Eleventh

3. *Com-Tel, Inc.* v. *DuKane Corp.*, 669 F.2d 404, 412-13 (6th Cir. 1982), dealt with a boycott conspiracy involving several competing distributors, not a two-firm supplier-purchaser "group boycott." *Cascade Cabinet Co.* v. *Western Cabinet & Millwork Co.*, 710 F.2d 1366, 1372-73 (9th Cir. 1983), did not deal with a two-firm supplier-purchaser situation; moreover, the court distinguished *Klor's* and declined to find a group boycott. The court below also gave a "*see also*" cite (11a) to *Cernuto, Inc.* v. *United Cabinet Corp.*, 595 F.2d 164, 168 (3d Cir. 1979), which was over-

Circuit in the decision cited by the court below, have expressly refused to extend *Klor's* to such situations.[4] Thus the holding of the court below that the group boycott doctrine of *Klor's* can be extended to two-firm supplier-purchaser situations has created a sharp conflict among circuits.

It has also created a direct conflict with the decision of this Court in *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988). The petitioner in that case argued that a vertical nonprice restraint could be condemned

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ruled by this Court in *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 720 n.1 (1988).

4. *See Bailey's, Inc.* v. *Windsor America, Inc.*, 948 F.2d 1018, 1031 (6th Cir. 1991) (no boycott where defendant "entered into no agreement with manufacturers of competing brands" and "did not conspire with resellers that were in competition with one another"); *Lomar Wholesale Grocery, Inc.* v. *Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 590-91 (8th Cir. 1987) (no boycott where there is no horizontal "collusion between competitors on the same market level"); *Westman Commission Co.* v. *Hobart Int'l, Inc.*, 796 F.2d 1216, 1224 n.1 (10th Cir. 1986) ("For a group boycott to exist, there must be an agreement among conspirators whose market positions are horizontal to each other."), *cert. denied*, 486 U.S. 1005 (1988); *Terry's Floor Fashions, Inc.* v. *Burlington Indus., Inc.*, 763 F.2d 604, 610 n.10 (4th Cir. 1985) (*Klor's* does not apply to termination of a distributor resulting from a conspiracy between a competing distributor and a manufacturer); *Construction Aggregate Transp., Inc.* v. *Florida Rock Indus., Inc.*, 710 F.2d 752, 775 n.42 (11th Cir. 1983) (boycott requires "mutual agreement between entities on the same market level"); *Products Liab. Ins. Agency, Inc.* v. *Crum & Forster Ins. Cos.*, 682 F.2d 660, 664-65 (7th Cir. 1982) (*Klor's* does not apply to agreement between supplier and distributor that supplier will not deal with another distributor); *Gough* v. *Rossmoor Corp.*, 585 F.2d 381, 387 (9th Cir. 1978) (no boycott where concert of action "was in no way an agreement between competitors"); *E.A. McQuade Tours, Inc.* v. *Consolidated Air Tour Manual Comm.*, 467 F.2d 178, 186 (5th Cir. 1972) (no boycott where no allegation that defendants conspired with competitors of plaintiff), *cert. denied*, 409 U.S. 1109 (1973); *Ark Dental Supply Co.* v. *Cavitron Corp.*, 461 F.2d 1093, 1094 (3d Cir. 1972) (*Klor's* does not apply to defendant's decision to sell only to its dealers).

as *per se* illegal under the group boycott rule of *Klor's* and *United States* v. *General Motors Corp.*, 384 U.S. 127 (1966). This Court rejected this argument, holding that the *per se* rule of *Klor's* and *General Motors* did not apply to the vertical relationship involved in *Business Electronics*, because "both [*Klor's* and *General Motors*] involved horizontal combinations . . . ." 485 U.S. at 734. This Court further explained:

> "Contrary to the dissent, *post*, at 742-743, 747, *General Motors* does not differ from the present case merely in that it involved a three-party rather than a two-party agreement. The agreement was among competitors in *General Motors*; it was between noncompetitors here. Cf. [Robert H.] Bork[, *The Antitrust Paradox*] 330 [(1978)] (defining 'boycotts' as 'agreements among competitors to refuse to deal')." 485 U.S. at 734 n.5.

The decision of this Court in *Business Electronics Corp.* v. *Sharp Electronics Corp.* is also directly at odds with the suggestion of the court below that a vertical agreement may be characterized as a horizontal restraint of trade if it seeks to disadvantage a competitor of one of the parties to the agreement (*see* 11a). In the *Business Electronics* case, this Court made clear that the test of a horizontal agreement is whether or not the agreement is between competitors, not whether or not the effects of the agreement are horizontal. 485 U.S. at 730-31 & n.4. Under this test, the agreement alleged in this case is undeniably vertical, not horizontal. Thus the decision below conflicts with the decision of this Court in *Business Electronics Corp.* v. *Sharp Electronics Corp.*, as well as with this Court's admonition that "the category of restraints classed as group boycotts is not to be expanded indiscriminately . . . ." *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458 (1986).

The Court of Appeals' extension of the group boycott rule of *Klor's* to vertical nonprice agreements is wrong in principle because, in the words of Professor Areeda, "the core reason for intense antitrust concern about 'boycotts' is the aggregation of the power of several competitors — a reason that does not apply to distribution restraints involving a single manufacturer's product." 8 Phillip E. Areeda, *Antitrust Law* ¶1644c, at 474 (1989). This extension of the group boycott rule also threatens serious injury to competition by providing an antitrust theory which disappointed would-be suppliers can use to challenge buyers' decisions to deal with other suppliers. Such a result would harm the very competition which it is the purpose of the antitrust laws to protect (*see* pp. 7-8 *supra*).

The Court of Appeals seemed uneasily aware that its new two-firm supplier-purchaser group boycott rule threatens to swallow up the rule that purchasers may choose their suppliers. In an apparent attempt to avert this result, the Court of Appeals acknowledged that exclusive distributorship agreements "are generally considered permissible under the rule of reason," and stated that "*in general*, two-firm vertical combinations will be scrutinized as exclusive distributorship controversies, rather than as group boycotts" (12a; emphasis in original). But the Court of Appeals did not explain how the courts are to distinguish lawful exclusive distributorship agreements from two-firm supplier-purchaser group boycotts, except to say that in the present case no "pro-competitive rationale appears on the face of the complaint" (*id.*).

This is an entirely unsatisfactory and unpredictable rule of law, for it makes the general rule that purchasers may choose their suppliers subject to defeasance whenever plaintiffs' counsel are able to draft complaints that omit to mention any "pro-competitive rationale." The unsatisfactory nature of the Court of Appeals' new rule of law is further shown by the

fact that, in applying the new rule to this case, the Court of Appeals overlooked the fact that Discon's own pleading alluded to several procompetitive reasons for not dealing with Discon.[5]

Thus this Court should grant certiorari to review the holding of the Court of Appeals insofar as it creates a new rule of two-firm supplier-purchaser group boycott, because this rule is directly at odds with the decision of this Court in *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988), and with the rulings of at least nine circuits.

II. The Court of Appeals Also Created a Conflict Among Circuits, and a Conflict With the Decisions of This Court, by Characterizing a Two-Firm Supplier-Purchaser Relationship as a Conspiracy to Monopolize.

In addition to its claim under Section 1 of the Sherman Act, Discon asserted every imaginable claim under Section 2 of the Sherman Act: monopolization, attempt to monopolize, and conspiracy to monopolize (JA148-JA150).

The Court of Appeals held that Discon's claims of monopolization and attempt to monopolize were properly dismissed because the NYNEX companies neither competed nor sought

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5. These included the following: (1) MECo stopped using Discon after an investigation revealed that Discon had made a loan (which it did not expect to be repaid) to Robert W. Zirkelbach, an employee of MECo who dealt with Discon (*see* JA127-JA128); (2) NYT stopped using Discon after it learned that Discon had hired Zirkelbach to work for it (JA128); and (3) questions were raised about the honesty, quality and safety of Discon's work (*see* JA126-JA127). Naturally, Discon's pleading did not admit that these reasons were valid; but these reasons were more than enough to indicate that the Court of Appeals was wrong in positing that this was a case in which no procompetitive reasons appeared on the face of Discon's pleading.

to compete in the market for removal services (13a-14a). Logically, this fact likewise called for dismissal of Discon's conspiracy to monopolize claim, which asserted that the NYNEX companies had a specific intent to monopolize the market for removal services (JA150).

Instead of dismissing Discon's conspiracy to monopolize claim, the Court of Appeals upheld it on a theory not pleaded by Discon. The Court of Appeals stated that "[a] defendant may be liable for conspiracy to monopolize where it agrees with another firm to assist that firm in its attempt to monopolize the relevant market" (14a). The Court of Appeals assumed (without citing any relevant authority) that this theory of conspiracy to monopolize is applicable where a purchaser agrees to buy from one supplier (the alleged would-be monopolist) rather than another, and where the purchaser's role in the alleged conspiracy to monopolize consists solely of favoring the alleged would-be monopolist as a supplier of the purchaser's needs.[6]

Here again, the Court of Appeals placed itself in conflict with other circuits. It is well established that a buyer's agreement to use one supplier rather than another does not constitute a conspiracy in restraint of trade in violation of Section 1 of the Sherman Act (*see* pp. 7-8 *supra*). The same principle is applicable to a conspiracy to monopolize under Section 2 of the Sherman Act,[7] and the courts have likewise held that

6. All of the overt acts alleged by Discon to be part of the alleged conspiracy to monopolize (*see* JA150) consisted of actions by the NYNEX companies that allegedly favored AT&T Technologies and discriminated against Discon as a supplier to the NYNEX companies (*see* JA121-JA129).

7. Eminent antitrust authorities have observed that a conspiracy to monopolize under Section 2 of the Sherman Act must necessarily also be a conspiracy in restraint of trade under Section 1 of the Sherman Act, so that conduct not constituting a restraint of trade cannot constitute a conspiracy to monopolize. *See* 3 Phillip E. Areeda & Donald F. Turner, *Antitrust Law* ¶ 839, at 358 (1978); Richard A. Posner, *Antitrust Law: An Economic Perspective* 216 (1976).

such an agreement does not constitute monopolization or a conspiracy to monopolize in violation of Section 2 of the Sherman Act.[8]

Even in the extreme case where the purchaser is the only customer in the relevant market, it is not a conspiracy to monopolize for the purchaser to switch its business from one supplier to another, even if the result is that the disfavored supplier goes out of business. As the Seventh Circuit said in a case in which such allegations were made,

> "Regardless of what travel agency C & J uses, that agency will have a large percentage of the business in the relevant market. This economic fact should not and cannot prevent C & J from switching travel agencies. *See Dunn & Mavis, Inc.* v. *Nu-Car Driveaway, Inc.*, 691 F.2d 241 (6th Cir. 1982) (loss of Chrysler's business would allegedly destroy plaintiff's business)." *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532, 540 (7th Cir. 1986).

If the law were otherwise — if a purchaser could not switch its business from one supplier to another without risking a claim of conspiracy to monopolize — the result would be the stifling of the very competition that the antitrust laws are

8. *See, e.g., Seagood Trading Corp.* v. *Jerrico, Inc.*, 924 F.2d 1555, 1576 (11th Cir. 1991); *Dreiling* v. *Peugeot Motors of America, Inc.*, 850 F.2d 1373, 1382 (10th Cir. 1988); *White* v. *Rockingham Radiologists, Ltd.*, 820 F.2d 98, 104-05 (4th Cir. 1987); *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532, 540-41 (7th Cir. 1986); *Walker* v. *U-Haul Co. of Miss.*, 747 F.2d 1011, 1015-16 (5th Cir. 1984); *Dunn & Mavis, Inc.* v. *Nu-Car Driveaway, Inc.*, 691 F.2d 241, 244-45 (6th Cir. 1982).

meant to advance. As this Court stated in *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 767 (1984),

> "an efficient firm may capture unsatisfied customers from an inefficient rival, whose own ability to compete may suffer as a result. This is the rule of the marketplace and is precisely the sort of competition that the Sherman Act aims to foster."

As this Court went on to point out in a footnote at this point, 467 U.S. at 767-68 n.14, this is true even where the result is the acquisition of monopoly power:

> "For example, the Court has declared that § 2 does not forbid market power to be acquired 'as a consequence of a superior product, [or] business acumen.' *United States* v. *Grinnell Corp.*, 384 U.S. 563, 571 (1966)."[9]

Thus the theory of the Court of Appeals that a buyer's choice of one supplier rather than another may be condemned as a conspiracy to monopolize is unsupportable.[10] Like the

9. Discon's allegation that NYT unjustifiably paid higher prices to AT&T Technologies does not change this result. To the extent that a regulated utility such as NYT unjustifiably pays higher prices, the resulting costs can be dealt with by regulatory authorities. *E.g.*, *Ehredt Underground, Inc.* v. *Commonwealth Edison Co.*, 90 F.3d 238, 240 (7th Cir. 1996). Indeed, as the court below admitted, such regulatory scrutiny took place in this case (5a).

10. In an apparent attempt to support this theory, the court below said that Discon's complaint could be read to assert that "MECo sought the dominance of AT&T Technologies in order to ensure the suppression of other suppliers who would bypass MECo and deal with NYTel directly" (15a). But, as the court recognized elsewhere in its opinion, MECo was in effect a purchasing agent for the NYNEX companies (9a-10a). Viewed against this background, there was nothing sinister or competitively significant about MECo's desire to deal with suppliers that would deal with MECo as a purchasing agent. It is commonplace for firms to require would-be suppliers to deal with them through a purchasing department or purchasing agent.

lower court's two-firm supplier-purchaser group boycott holding, its conspiracy to monopolize holding creates a conflict among circuits and with the decisions of this Court, and opens the door to a wave of treble damage actions by would-be suppliers seeking to challenge a defendant's decision to use another supplier. Certiorari should be granted to review and reverse this holding.

CONCLUSION

For the reasons set forth above, the Court should grant a writ of certiorari, and should summarily reverse the judgment of the United States Court of Appeals for the Second Circuit on the ground that it is contrary to *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988). In the alternative, the Court should grant a writ of certiorari and set the case down for briefing and argument.

Dated: April 3, 1997

Respectfully submitted,

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, New York 10017
(212) 450-4192

EDWARD S. BLOOMBERG
KEVIN J. ENGLISH
PHILLIPS, LYTLE, HITCHCOCK,
BLAINE & HUBER
One Marine Midland Center
Buffalo, New York 14203
(716) 847-8400

Counsel for Petitioners

APPENDICES

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1126—August Term 1995
Argued: March 27, 1996 Decided: August 26, 1996
Docket No. 95-7673

DISCON, INCORPORATED,

Plaintiff-Appellant,

— v. —

NYNEX CORPORATION, NYNEX MATERIAL ENTERPRISES, NEW YORK TELEPHONE COMPANY, ROBERT J. ECKENRODE, and BERNARD O'REILLY,

Defendants-Appellees.

Before:

NEWMAN, *Chief Judge*,
OAKES and PARKER, *Circuit Judges*.

Appeal from the June 14, 1995, judgment of the United States District Court for the Western District of New York (Richard J. Arcara, Judge) dismissing plaintiff-appellant's antitrust and RICO complaint for failure to state a claim upon which relief can be granted.

Affirmed in part, reversed in part, and remanded for further proceedings.

SAMUEL A. CHERNIAK, New York, N.Y. (Phyllis Gelman, Gelman & Feinberg, New York, N.Y.; Goldstein, Navagh, Bulan & Chiari, Buffalo, N.Y., on the brief), *for plaintiff-appellant.*

GUY M. STRUVE, New York, N.Y. (James D. Liss, Vincent T. Chang, Seth R. Lesser, Davis Polk & Wardwell; Edward S. Bloomberg, Kevin J. English, Phillips, Lytle, Hitchcock, Blaine & Huber, Buffalo, N.Y., on the brief), *for defendants-appellees.*

JON O. NEWMAN, *Chief Judge:*

This appeal involves an antitrust suit brought by a former supplier alleging that its purchaser and a competitor acted in violation of the Sherman Act and the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Plaintiff-appellant Discon, Inc. ("Discon") appeals from the June 14, 1995, judgment of the United States District Court for the Western District of New York (Richard J. Arcara, Judge). The District Court dismissed Discon's amended complaint pursuant to Fed. R. Civ. P. 12(b)(6) for failure to state a claim upon which relief can be granted. Discon argues that the District Court erred in holding that its complaint fails to allege a violation of either Section One or Section Two of the Sherman Act, 15 U.S.C. §§ 1, 2 (1994), or RICO, 18 U.S.C. § 1962 (1994). Because we believe that the District Court

prematurely dismissed two of Discon's claims, we affirm in part, reverse in part, and remand.

Background

Discon is a New York corporation whose primary business is the provision of "removal services" to telephone companies. These removal services include salvaging and disposing of obsolete telephone central office equipment. Discon was first formed in June 1984 to meet a demand created by the court-ordered break-up of the American Telephone and Telegraph Company ("AT&T"), *see generally United States* v. *American Telephone and Telegraph Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland* v. *United States*, 460 U.S. 1001 (1983). Prior to 1984, AT&T was able to monopolize the market for telecommunications equipment, including the market for removal services, through its ownership of the regional Bell Operating Companies ("BOCs"). AT&T would compel the BOCs to purchase supplies only from AT&T and its manufacturing affiliates, the Western Electric Co. and Bell Telephone Laboratories. In this manner, AT&T was able to extend the regulated monopoly power of its BOCs into other non-regulated markets. *Id.* at 222-23. Pursuant to the Consent Decree of 1984, AT&T divested itself of control over the BOCs. Thereafter, each BOC was instructed to purchase its products and services from a competitive field of suppliers. *Id.* at 227. Discon became one of those suppliers of removal services in the New York State area.

NYNEX Corp. ("NYNEX") is a successor entity that emerged out of the 1984 divestiture and replaced the BOCs that operated in New York and New England. NYNEX itself is a holding company that controls several wholly-owned subsidiaries, including NYNEX Material Enterprises ("MECo")

and two local telephone service providers, New York Telephone Co. ("NYTel") and New England Telephone and Telegraph Co. ("NET").[1] Within the NYNEX structure, MECo is a Delaware corporation whose primary business is the procurement of goods and services for NYNEX and its affiliated corporations, including NYTel. In effect, MECo serves as a purchasing agent for NYNEX and its other subsidiaries. NYTel is a New York corporation that provides local telephone service to most of New York State and some portions of Connecticut. NYTel is the dominant purchaser of removal services in the New York State area. As a regulated monopoly under the New York Public Service Laws, NYTel is subject to the state rate-making process. NYNEX and MECo, however, are not subject to state regulation.

AT&T Technologies is a wholly-owned subsidiary of AT&T, and is the successor entity to the Western Electric Co.[2] AT&T Technologies provides numerous network services, including removal services, to telephone companies throughout the United States. Within the New York State area, AT&T Technologies competes directly with Discon in the market for removal services.

Discon's complaint alleges that NYNEX, MECo, and NYTel (collectively, the "NYNEX Defendants") conspired with AT&T Technologies to eliminate Discon from the market for removal services. The crux of this conspiracy was a scheme to defraud the rate-paying public. During the mid-

1. NET is not named as a defendant in this lawsuit, nor is it otherwise involved in these proceedings.

2. Although AT&T Technologies is alleged by Discon to be a co-conspirator with NYNEX, MECo, and NYTel, it is not named as a defendant in this lawsuit.

1980s, MECo, as a non-regulated affiliate of NYNEX, would purchase removal services at inflated prices from AT&T Technologies. These removal services, along with their inflated prices, were then passed on to NYTel, a regulated affiliate of NYNEX. In turn, NYTel was able to overcharge its captive rate-paying customers pursuant to the rate-making process. MECo would then recoup its inflated costs by receiving a secret year-end "rebate" from AT&T Technologies. Thus, without being subject to any oversight from the state regulatory commission, MECo and its parent company, NYNEX, were able to generate increased revenues that were essentially derived from NYTel's telephone monopoly. This scheme was replicated in numerous contexts by the NYNEX Defendants for other capital goods and services purchased by NYTel. *See In re New York Telephone Co.*, 5 F.C.C.R. 866 (1990) ("*FCC Order*").

In an independent regulatory proceeding, the Federal Communications Commission ("FCC") found that this method of generating revenues — using MECo as an "outside" profit center — violated the Communications Act of 1934, 47 U.S.C. § 201(b) (1988). The FCC ordered NYTel to issue a rebate to its rate-paying customers for overcharges that occurred between 1984 and 1988. *FCC Report*, 5 F.C.C.R. 866. The FCC and NYTel subsequently entered into a consent decree. *See In re New York Telephone Co.*, 5 F.C.C.R. 5892 (1990) ("*FCC Consent Decree*"). Without admitting any wrongdoing or violations, NYTel agreed to refund over $35 million for "unreasonable rates reflecting improper capital costs and expense charges." *Id.*

Discon alleges that, as part of this conspiracy to defraud the rate-paying public, NYNEX and MECo, in purchasing removal services for NYTel, discriminated against Discon in

favor of AT&T Technologies because Discon refused to inflate its prices. Also, Discon would sometimes contract directly with NYTel, thus bypassing MECo altogether and undermining the basic premise of the outside profit-center scheme. Discon claims that, in retaliation for its non-cooperation, MECo and AT&T Technologies conspired to disseminate false information about Discon, to burden Discon with undue obligations under threat of economic duress, and to give preferential treatment to AT&T Technologies.

Discon filed its original complaint in the Western District of New York in May 1990, alleging that the NYNEX Defendants had violated Section One and Section Two of the Sherman Act and RICO. In June 1992, the District Court granted an initial motion to dismiss with leave to replead. Shortly thereafter, Discon filed an amended complaint, and the NYNEX Defendants moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). On June 14, 1995, the District Court dismissed with prejudice.

Discussion

I. Section One of the Sherman Act

This appeal typifies one of the primary difficulties in the judicial application of antitrust law. Under Section One of the Sherman Act, courts are asked to categorize various complex commercial arrangements into a rigid legal taxonomy, *e.g.*, horizontal restraint, vertical restraint, price-fixing, market division, concerted refusal to deal, and so on. This initial categorization is often outcome-determinative. Under one category, the arrangement may be *per se* illegal, while under another, it may be found permissible under the rule of reason. Due to the complexity of modern business transactions, however, courts often find that commercial

arrangements can be classified theoretically under a number of different categories. *See Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*, 441 U.S. 1, 8 (1979) (''[E]asy labels do not always supply ready answers.'') In this case, we believe that the District Court may have been misled by a poorly drafted complaint into categorizing the arrangement as one that is presumptively legal. Since the complaint may properly be understood to allege arrangements that might be shown to be unlawful, we are obliged to reverse in part and remand. We believe that the complaint states a cause of action under Section One of the Sherman Act, though under a different legal theory than the one articulated by Discon.

To state a claim under Section One of the Sherman Act, Discon must allege (1) that the NYNEX Defendants entered into a contract, combination, or conspiracy, and (2) that their agreement was in restraint of trade. *See* 15 U.S.C. § 1.[3] Traditionally, restraints of trade are classified as either horizontal restraints or vertical restraints. *See Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 730 (1984) (''*Sharp*''). Horizontal restraints are generally considered illegal *per se* if they fall within certain broad categories. *See United States* v. *Topco Associates, Inc.*, 405 U.S. 596, 608

3. The NYNEX Defendants devote a single footnote in their brief to the argument that Discon failed to allege a ''conspiracy'' in restraint of trade. *See Monsanto Co.* v. *Spray-Rite Co.*, 465 U.S. 752, 765-67 (1984) (requirement of ''concerted action''). Although Discon's complaint is not a model of clarity, it alleges that NYNEX, MECo, and AT&T Technologies conspired to defraud the rate-paying public and that this agreement apparently contemplated some form of discrimination against Discon. More specifically, the complaint alleges the existence of various meetings between NYNEX procurement personnel, MECo officers, and agents of AT&T Technologies. These allegations are sufficient to defeat a motion to dismiss.

(1972) (market division); *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207, 211-12 (1959) (concerted refusal to deal); *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940) (horizontal price-fixing). Vertical restraints are illegal *per se* only where the agreement contains a further arrangement to fix prices, *i.e.*, vertical price-fixing. *See Sharp*, 485 U.S. at 724. Other types of horizontal restraints and vertical non-price restraints are assessed under the rule of reason. *Id.* at 726.

Discon alleges primarily that the NYNEX Defendants engaged in an unlawful horizontal restraint of trade. The complaint asserts that Discon, MECo, and AT&T Technologies were all providers of removal services to NYTel, and that MECo and AT&T Technologies entered into a conspiracy to discriminate against Discon. The complaint thus alleges a classic horizontal restraint of trade — an agreement between two potential rivals seeking to disadvantage a third competitor. *See* E. Thomas Sullivan & Jeffrey L. Harrison, *Understanding Antitrust and Its Economic Implications* § 4.13, at 110 (2d ed. 1994) (hereinafter "Sullivan, *Understanding Antitrust*"). In support of this theory, Discon alleges that MECo is a "supplier" of removal services, along with Discon and AT&T Technologies. The District Court, however, found this to be a mischaracterization. We agree. It is undisputed that MECo itself does not perform any removal services for NYTel. Rather, as the complaint acknowledges, "MECo's primary business function is *procuring* goods and services for New York Telephone [NYTel] . . . and for NYNEX Service Company." Thus, MECo acts essentially as a purchasing agent for NYNEX and NYTel, and in fact, it often served as an intermediary between NYTel and its actual suppliers, Discon and AT&T Technologies. *See Westchester*

Radiological Associates v. *Empire Blue Cross and Blue Shield, Inc.*, 707 F. Supp. 708, 712-13 (S.D.N.Y.) ("antitrust remedy" does not apply "where a buyer insists on buying his services through an intermediary"), *aff'd on opinion below*, 884 F.2d 707, 708 (2d Cir. 1989), *cert. denied*, 493 U.S. 1095 (1990).

It is true that, at times, NYTel would contract directly with Discon or other suppliers, and in those situations, presumably MECo would lose the opportunity to derive a commission. Therefore, in one sense, MECo could be considered, if not a supplier, at least a competitor with Discon and AT&T Technologies. Nonetheless, we decline to adopt this line of analysis for two reasons. First, MECo by its very nature transacts business for only one purchaser, NYTel. Unlike other intermediaries, such as wholesalers, who may transfer goods and services to a number of different purchasers, MECo does not resell removal services to any other telephone company.[4] Thus, MECo does not compete in the overall market for removal services, but only in the "market" for a single buyer. Second, the fact that MECo and NYTel are both affiliated under the same corporate structure strengthens the analogy of MECo to that of an internal purchasing agent. If MECo were organized as a purchasing department within NYTel, rather than as a separate corporate entity, it would be undisputed that MECo did not compete with Discon or AT&T Technologies. We believe it would be incongruous to apply a different rule of law simply because MECo holds its own corporate charter. *Cf. Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977) (courts in antitrust cases

4. Discon's complaint reveals at least one other telephone company, AT&T Communications, that purchases removal services in the New York State area.

should eschew "formalistic line drawing"). The fact remains that MECo acts at the behest of NYNEX and NYTel, and its actions are guided by a single corporate consciousness. *Cf. Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 771 (1984) (parent corporation and wholly-owned subsidiary are "single enterprise" for purpose of conspiracy requirement under Section One). A firm does not become a competitor of one of its suppliers solely by virtue of reselling goods or services to an affiliate under common ownership.

Since MECo is not a supplier of removal services and does not otherwise compete with Discon and AT&T Technologies in the overall market, Discon cannot succeed on its theory of a classic horizontal restraint of trade.[5] Nonetheless, we believe that Discon may be able to prevail under a different legal theory. In *Oreck Corp.* v. *Whirlpool Corp.*, 579 F.2d 126 (2d Cir.) *(in banc), cert. denied*, 439 U.S. 946 (1978), we noted that an agreement between two firms (*e.g.*, MECo and

5. Discon also argues that the agreement between MECo and AT&T Technologies could be characterized as a vertical agreement to fix prices. *See Sharp*, 485 U.S. at 724-26; *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911). We believe, however, that Discon has not stated a cause of action under a theory of vertical price-fixing. Discon admits that its allegations merely raise the "inference" that AT&T Technologies and MECo "intended" to influence the prices that MECo charged to NYTel. Yet this inference arises whenever a supplier sells its products to a purchasing agent. The price agreed upon between the supplier and the purchasing agent will by definition exert some influence upon the final price that the purchasing agent passes on to its client. Discon does not allege that MECo was in any way restricted in its freedom to set whatever prices it charged to NYTel. Therefore, the arrangement between MECo and AT&T Technologies cannot be characterized as one to "fix" prices. *See Sharp*, 485 U.S. at 731 (vertical price-fixing conspiracy must contain "some agreement on price or price levels").

AT&T Technologies), even in a vertical relationship, may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor (*e.g.*, Discon) of one of the conspiring firms. *Id.* at 131-32 & n.6; *see* Sullivan, *Understanding Antitrust, supra*, § 4.13, at 110 (describing different types of concerted refusals to deal); L. Sullivan, *Handbook of the Law of Antitrust* 230-31 & n.1 (1977) (same). *Oreck* sought to elaborate on the Supreme Court's decision in *Klor's*, 359 U.S. at 211-12, where the Court held that a retailer may not induce its manufacturers to refrain from selling to a competing retailer. In *Klor's*, the agreements between the defendant-retailer and its manufacturers were essentially vertical in nature. Yet the Supreme Court applied a "group boycott" theory because it found that the intent and effect of these vertical agreements was a horizontal market impact. *Id.*

It is true that *Klor's* is not directly on point, because in that case numerous manufacturers participated in a group boycott, whereas here the complaint alleges only a single boycotting firm, MECo, and a single competitor, AT&T Technologies. Nonetheless, *Klor's* has been extended in the Sixth and Ninth Circuits to the situation where only a single retailer and a single manufacturer conspire. *See Com-Tel, Inc.* v. *DuKane Corp.*, 669 F.2d 404, 411-13 & nn. 13, 16 (6th Cir. 1982); *Cascade Cabinet Co.* v. *Western Cabinet & Millwork Inc.*, 710 F.2d 1366, 1370-71 (9th Cir. 1983); *see also Cernuto, Inc.* v. *United Cabinet Corp.*, 595 F.2d 164, 168 (3d Cir. 1979). The Eleventh Circuit, on the other hand, has expressly declined to extend *Klor's* in such a manner. *See Construction Aggregate Transport, Inc.* v. *Florida Rock Industries, Inc.*, 710 F.2d 752, 776-78 (11th Cir. 1983); *see also Westman Commission Co.* v. *Hobart International, Inc.*, 796 F.2d 1216,

1224 n.1 (10th Cir. 1986), *cert. denied*, 486 U.S. 1005 (1988).

We can understand why some courts are reluctant to extend *Klor's* to two-firm group boycotts, since such arrangements will often resemble exclusive distributorship agreements, which are generally considered permissible under the rule of reason. *See Oreck*, 579 F.2d at 131. We emphasize that our decision should not be read to conflict with the holding in *Oreck* that, *in general*, two-firm vertical combinations will be scrutinized as exclusive distributorship controversies, rather than as group boycotts. *Id.; see also Sharp*, 485 U.S. at 725-31 & n.4 (two-firm group boycott should be judged under rule of reason); *K.M.B. Warehouse Distributors, Inc.* v. *Walker Manufacturing Co.*, 61 F.3d 123, 127 (2d Cir. 1995) (decision to use one distributor over another does not violate Section One). Yet *Oreck* cautioned that it may not always be true that two-firm group boycotts are permissible; rather, "a careful scrutiny into the business justifications for the agreement is required." *Id.* at 132 n.6.

In the vast majority of cases, the decision to discriminate in favor of one supplier over another will have a pro-competitive intent and effect. *Cf. Sharp*, 485 U.S. at 724-25. Presumably, the purchaser will have chosen a particular supplier because that firm provides certain efficiencies that allow the purchaser to compete more effectively in the market for sales to the ultimate consumer. In this case, however, no such pro-competitive rationale appears on the face of the complaint. Discon alleges that the intent and effect of choosing AT&T Technologies over Discon was entirely anti-competitive. Although the NYNEX Defendants may be able to present some pro-competitive justification for choosing a more costly supplier in order to overcharge captive rate-paying customers, this justification, if it exists, remains unproven. We conclude

that Discon has alleged a cause of action under, at least, the rule of reason, and possibly under the *per se* rule applied to group boycotts in *Klor's*, if the restraint of trade "'has no purpose except stifling competition.'" *Oreck*, 579 F.2d at 131 (quoting *White Motor Co.* v. *United States*, 372 U.S. 253, 263 (1963)).[6]

II. Section Two of the Sherman Act

Discon also alleges that the NYNEX Defendants violated Section Two of the Sherman Act by engaging in monopolization, attempted monopolization, and conspiracy to monopolize. *See* 15 U.S.C. § 2. We consider each of these claims separately.

A. Monopolization

To state a claim for monopolization, Discon must allege, among other things, that the defendants possess monopoly power in a relevant market. *See United States* v. *Grinnell*, 384 U.S. 563, 570 (1966). In this case, however, none of the NYNEX Defendants competes in the relevant market for removal services. NYNEX and NYTel are purchasers, not suppliers, of removal services, and MECo, as we have noted, is only a purchasing agent for NYTel and cannot be considered a competitor in the overall market.[7] Thus, Discon's

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6. We do not decide at this point whether the District Court on remand should apply a *per se* rule; however, we note that the traditional rationale for applying the rule of reason to two-firm group boycotts — the promotion of interbrand competition over intrabrand competition — does not exist in this case. *Cf. Sharp*, 485 U.S. at 724-25; *Oreck*, 579 F.2d at 131.

7. The only conspiring firm that competes in the market for removal services is AT&T Technologies; however, it is not named as a defendant in this lawsuit.

claim of monopolization must fail, since it is axiomatic that a firm cannot monopolize a market in which it does not compete. *See Official Airlines Guides, Inc.* v. *FTC*, 630 F.2d 920, 925-27 (2d Cir. 1980), *cert. denied*, 450 U.S. 917 (1981); *FLM Collision Parts, Inc.* v. *Ford Motor Co.*, 543 F.2d 1019, 1030 (2d Cir. 1976), *cert. denied*, 429 U.S. 1097 (1977).

B. Attempted Monopolization

Discon's claim of attempted monopolization fails for the same reason. To state a cause of action for attempted monopolization, Discon must allege, among other things, that there is a "dangerous probability" that the attempt will succeed. *See International Distribution Centers, Inc.* v. *Walsh Trucking Co.*, 812 F.2d 786, 790 (2d Cir.), *cert. denied*, 482 U.S. 915 (1987). In this case, there was no "dangerous probability" that the NYNEX Defendants would succeed in monopolizing the market for removal services, since they do not even compete in that market and there is no indication that they ever sought to do so. *See FLM Collision Parts*, 543 F.2d at 1030.

C. Conspiracy to Monopolize

To state a claim for conspiracy to monopolize, Discon must allege that there was (1) concerted action, (2) overt acts in furtherance of the conspiracy, and (3) specific intent to monopolize. *See International Distribution Centers*, 812 F.2d at 795. Unlike the previous two Section Two claims, to be liable for conspiracy to monopolize, it is not necessary that the NYNEX Defendants compete directly in the market for removal services. A defendant may be liable for conspiracy to monopolize where it agrees with another firm to assist that firm in its attempt to monopolize the relevant market. We

conclude that the complaint sufficiently alleges that the NYNEX Defendants conspired with AT&T Technologies and performed overt acts intending to assist AT&T Technologies in its monopolization of the market for removal services. The requirement of pleading specific intent is met insofar as Discon alleges that MECo sought the dominance of AT&T Technologies in order to ensure the suppression of other suppliers who would bypass MECo and deal with NYTel directly. Therefore, since Discon has alleged the essential elements of a conspiracy to monopolize, the District Court should not have dismissed this claim.

III. Civil RICO

Finally, Discon alleges several violations of RICO, 18 U.S.C. § 1962. Discon alleges that the NYNEX Defendants violated subsections 1962(b), (c), and (d). All three of these claims were properly dismissed by the District Court.

A. Subsection 1962(b)—RICO acquisition

Discon first alleges a violation of subsection 1962(b), which prohibits the "acquisition or maintenance" of an enterprise through a pattern of racketeering activity. Defining the relevant "enterprise" as NYTel, Discon claims that NYNEX and MECo controlled NYTel through a number of illegal predicate acts. It is undisputed, however, that NYNEX acquired legal control over NYTel during the 1984 divestiture. Discon does not allege any facts to support a finding that this control, which exists by virtue of stock ownership in a wholly-owned subsidiary, was "acquired" or "maintained" through a pattern of racketeering activity.

Moreover, Discon has not alleged the sort of "acquisition injury" necessary to state a claim under subsection 1962(b).

We have held, in the context of subsection 1962(a), prohibiting the "use or investment of income" derived from a pattern of racketeering activity, that "the essence of a violation of § 1962(a) is not commission of predicate acts but investment of racketeering income." *Ouaknine* v. *MacFarlane*, 897 F.2d 75, 82-83 (2d Cir. 1990). In the context of subsection 1962(a), therefore, we have required that the plaintiff allege a "use or investment injury" that is distinct from the injuries resulting from predicate acts.

Similarly, other circuits have held that, in order to state a cause of action under subsection 1962(b), "plaintiffs must allege an 'acquisition' injury, analogous to the 'use or investment injury' required under § 1962(a) to show injury by reason of a § 1962(b) violation." *Danielsen* v. *Burnside-Ott Aviation Training Center, Inc.*, 941 F.2d 1220, 1231 (D.C. Cir. 1991); *accord Compagnie de Reassurance d'Ile de France* v. *New England Reinsurance Corp.*, 57 F.3d 56, 92 (1st Cir.), *cert. denied*, 116 S. Ct. 564 (1995); *Lightning Lube, Inc.* v. *Witco Corp.*, 4 F.3d 1153, 1191 (3d Cir. 1993); *Old Time Enterprises, Inc.* v. *International Coffee Corp.*, 862 F.2d 1213, 1219 (5th Cir. 1989). In this case, Discon has not alleged any injury stemming from the "acquisition or maintenance" of NYTel by NYNEX and MECo, only injuries resulting from the commission of predicate acts. Without a distinct "acquisition injury," Discon cannot state a cause of action under subsection 1962(b).

B. Subsection 1962(c)—RICO conduct

Discon also alleges a violation of subsection 1962(c), which prohibits "any person employed by or associated with any enterprise . . . to conduct . . . such enterprise's affairs through a pattern of racketeering activity . . . ." 18 U.S.C.

§ 1962(c).[8] For this claim, Discon redefines the enterprise as the "NYNEX Group," which consists of the three corporations, NYNEX, MECo, and NYTel. Discon claims that these three corporate "persons" conducted the affairs of the NYNEX Group "enterprise" through a number of illegal predicate acts.

We have previously held, however, that subsection 1962(c) "clearly envisions" that the "person" and the "enterprise" will be distinct. *Bennett* v. *United States Trust Co.*, 770 F.2d 308, 315 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986). "[A] corporate entity may not be simultaneously the 'enterprise' and the 'person' who conducts the affairs of the enterprise through a pattern of racketeering activity." *Id.* In *Riverwoods Chappaqua Corp.* v. *Marine Midland Bank*, 30 F.3d 339 (2d Cir. 1994), we explained further that the distinctiveness requirement of *Bennett* may not be circumvented "by alleging a RICO enterprise that consists merely of a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant . . . ." *Id.* at 344. "Where employees of a corporation associate together to commit a pattern of predicate acts in the course of their employment and on behalf of the corporation, the employees in association with the corporation do not form an enterprise distinct from the corporation." *Id.* Thus, in *Riverwoods*, we found that the activities of two loan officers "acting within the scope of their authority" could not subject them to RICO

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8. Unlike subsections 1962(a) and (b), under subsection 1962(c), a plaintiff need not allege a distinct "racketeering injury" in order to state cause of action. *See Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 494-95 (1985).

liability for conducting the affairs of the alleged enterprise-bank.

In response, Discon cites *Cullen* v. *Margiotta*, 811 F.2d 698 (2d Cir.), *cert. denied*, 483 U.S. 1021 (1987), for the proposition that a defendant may simultaneously be a RICO "person" and one of a number of members in the RICO "enterprise." *Id.* at 729-30. In *Cullen*, the enterprise was defined as an association of three separate entities — a municipality, the town Republican Committee, and the county Republican Committee. *Id.* at 728. We held that any of the three individual entities could be convicted under subsection 1962(c) for its participation in the tripartite enterprise.

The difference between *Riverwoods* and *Cullen* appears to lie in the fact that *Riverwoods* involved only a single corporate entity that was associated with its employees, whereas *Cullen* involved three legally separate entities that could be differentiated from the enterprise-group. Moreover, in *Riverwoods*, the individual defendants were acting on behalf of the enterprise-corporation, and therefore, it would have been especially inappropriate to hold that they were "distinct" from the enterprise.

In this case, we confront a situation that lies somewhere between *Riverwoods* and *Cullen*. Like the defendants in *Riverwoods*, NYNEX, MECo and NYTel operate within a unified corporate structure. At the same time, however, they are also legally separate entities from each other and from the NYNEX Group. Although our decision is by no means dictated by clear precedent, we believe that *Riverwoods* presents the more analogous situation. The relationship between NYNEX, MECo, and NYTel in comparison to the NYNEX

Group is not substantially different from that between the loan officers in *Riverwoods* in comparison to the bank. In both cases, the individual defendants were acting within the scope of a single corporate structure, guided by a single corporate consciousness. It would be inconsistent for a RICO person, acting within the scope of its authority, to be subject to liability simply because it is separately incorporated, whereas otherwise it would not be held liable under *Riverwoods*. *But see Haroco, Inc.* v. *American National Bank & Trust Co.*, 747 F.2d 384, 402 (7th Cir. 1984) (wholly-owned subsidiary is technically distinct from parent corporation and may be liable under RICO), *aff'd on other grounds*, 473 U.S. 606 (1985).

Discon's reference to unnamed "attorneys, accountants and other agents" as part of the enterprise does not alter this analysis. *Riverwoods* expressly applies to "agents" as well as "employees" so long as those persons act on behalf of the corporation. Although the situation might be different if the defendants were acting outside the scope of their agency, this situation is not presented here.

C. Section 1962(d)—RICO conspiracy

Lastly, Discon alleges a violation of subsection 1962(d), which prohibits any conspiracy to commit a RICO violation. Discon's complaint incorporates its prior two claims by reference and simply adds the further allegation that the NYNEX Defendants "consciously agreed to join and to enter a conspiracy" to commit these substantive acts. Since we have held that the prior claims do not state a cause of action for substantive violations of RICO, the present claim does not set forth a conspiracy to commit such violations. *See Lightning*

Lube, 4 F.3d at 1191 (''Any claim under § 1962(d) based on conspiracy to violate the other subsections of section 1962 necessarily must fail if the substantive claims are themselves deficient.''); *Danielsen*, 941 F.2d at 1232.

Conclusion

We affirm the judgment of the District Court insofar as it dismissed Discon's claims for vertical price-fixing under Section One of the Sherman Act, for monopolization and attempted monopolization under Section Two of Sherman Act, and for RICO acquisition, RICO conduct, and RICO conspiracy under RICO. We reverse the judgment of the District Court and remand for further proceedings with regard to Discon's claims of an unlawful two-firm group boycott under Section One of the Sherman Act, and a conspiracy to monopolize under Section Two of the Sherman Act.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

DISCON, INCORPORATED,

Plaintiff,

v.

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES,
NEW YORK TELEPHONE,
ROBERT J. ECKENRODE,
BERNARD O'REILLY,

Defendants.

DECISION AND ORDER
90-CV-546A

INTRODUCTION

Defendants, NYNEX Corporation (''NYNEX''), NYNEX Materiel Enterprises (''MECo''), New York Telephone (''NYT''), Robert J. Eckenrode (''Eckenrode''), and Bernard O'Reilly (''O'Reilly''), have moved to dismiss Discon Incorporated's (''Discon'') Amended Complaint pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6). They have also moved, pursuant to Fed. R. Civ. P. 11, for sanctions against Discon and its counsel for filing the Amended Complaint without conducting a reasonable inquiry into the law.

After reviewing the submissions of the parties and hearing argument from counsel, the Court grants defendants' motion to dismiss the Amended Complaint for failure to state a claim. Defendants' motion for sanctions is denied.

BACKGROUND

The Court granted defendants' motion to dismiss plaintiff's original Complaint ("Complaint") without prejudice in a Decision and Order filed on June 23, 1992 ("Decision"). The Court denied defendants' motion for sanctions, also without prejudice. Plaintiff was granted leave to amend the Complaint. Plaintiff filed an Amended Complaint and a RICO Case Statement on July 31, 1992. The Amended Complaint includes thirteen causes of action.

DISCUSSION

I. Motion to Dismiss

In deciding defendants' motion to dismiss the Amended Complaint for failure to state a claim upon which relief can be granted, the Court applies the same standards as those governing the adequacy of an original filed pleading. *Ricciuti* v. *N.Y.C. Transit Auth.*, 941 F.2d 119, 123 (2d Cir. 1991). The Court is required to accept the well-pleaded factual allegations of the Amended Complaint as true. *Branum* v. *Clark*, 927 F.2d 698, 705 (2d Cir. 1991) (citing *Cooper* v. *Pate*, 378 U.S. 546 (1964) (per curiam)); *Dwyer* v. *Regan*, 777 F.2d 825 (2d Cir. 1985), *modified on other grounds*, 793 F.2d 457 (2d Cir. 1986). The allegations of the Amended Complaint must be construed in Discon's favor. *Papasan* v. *Allain*, 478 U.S. 265, 283 (1986); *Scheuer* v. *Rhodes*, 416 U.S. 232, 236 (1974). Indeed, the Court cannot grant the motion to dismiss unless "it is clear that no relief [can] be granted under any set of facts that [can] be proved consistent with the allegations." *H.J., Inc.* v. *Northwestern Bell Tel. Co.*, 492 U.S. 229, 249-50 (1989) (quoting *Hishon* v. *King & Spalding*, 467 U.S. 69, 73 (1984)); *see also Conley*

v. *Gibson*, 355 U.S. 41, 45-46 (1957).

Applying these principles, the Court concludes that Discon's Amended Complaint must be dismissed.

A. Amended Complaint[1]

Plaintiff Discon is incorporated in New York State. It was formed in June of 1984 by Robert Faltisco. Its primary business is the provision of "removal services," which includes the salvage and disposal of obsolete telephone central office equipment. Amended Complaint ¶ 13.

Discon was formed to meet a demand created by the January 1, 1984 court-ordered break up of American Telephone and Telegraph Company and its affiliates Western Electric Company, Inc., and Bell Telephone Laboratories, Inc. (collectively "old AT&T") into competing enterprises. Among other things, the terms of the breakup of old AT&T require that all carriers of telephone calls between different exchanges have access to other exchanges that are equal in type, price and quality to the access provided to AT&T and its affiliates. *See United States* v. *American Tel. & Tel. Co.*, 552 F. Supp. 131, 227 (D.D.C. 1982), *aff'd sub nom. Maryland* v. *United States*, 460 U.S. 1001 (1983).

From the time it was formed in June of 1984, through 1986, Discon supplied central office equipment removal services to NYT. NYT was Discon's principal customer, if not its only one.

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1. A full description of the background of this litigation is set out in the Court's Decision dismissing the Complaint, at pages 3-7. The Court repeats here only those portions which are helpful for understanding the instant proceeding.

Defendant NYT is a New York corporation that provides local telephone exchange service in most of New York State and some portions of Connecticut. NYT is a wholly owned subsidiary of NYNEX. Because NYT is in a business subject to New York State Public Service Law, its profits are regulated. NYNEX's profits are not. NYT is a dominant purchaser of removal services in the New York State area. Amended Complaint ¶¶ 14, 29.

Defendant MECo is incorporated under the laws of Delaware and is a subsidiary of NYNEX. Its primary business function is procuring goods and services for NYT and New England Telephone and Telegraph ("NET"). Amended Complaint ¶ 16.

American Telephone and Telegraph Company ("AT&T") is the parent company of AT&T Technologies ("Technologies").[2] Technologies is the former Western Electric Company, Inc. and is a supplier of network services, among its other operations. In the course of its network services business, Technologies supplies central office equipment removal services to NYT. Technologies is the dominant supplier of removal services in New York State. Amended Complaint ¶ 26. Discon alleges that NYNEX, through its affiliates NYT and MECo, and Technologies conspired to monopolize the market for removal services and took concerted action to drive Discon from the market for removal services. Amended Complaint ¶ 2.

Discon further alleges that MECo favored Technologies over Discon when purchasing central office equipment removals required by NYT and that MECo and Technologies

2. Neither AT&T or Technologies are defendants in this action.

maintained an artificially high price for removal services provided to NYT. MECo was allegedly motivated to favor Technologies over Discon, and to undermine Discon, so that it could markup the price of central office removals it charged its regulated affiliate, NYT. MECo's inflated prices for central office removals made for allegedly high profits, some of which MECo paid to NYNEX as dividends. Acting in concert, Technologies and MECo used markups and rebates to divide the monopoly profits derived from the sale of removal services to NYT. Amended Complaint ¶ 31.

Discon continued to work for NYT until June 1986, when it was suspended as a supplier eligible to offer central office removal services to NYT. Plaintiff alleges that it stopped working for NYT after it hired a former employee of MECo, Robert Zirkelbach. Zirkelbach resigned from MECo on July 9, 1985 after an internal investigation by NYT Security. Plaintiff alleges that NYT falsely told the Public Service Commission that Discon made Zirkelbach a loan that it did not expect Zirkelbach to repay. Amended Complaint ¶¶ 50-55.

The Amended Complaint refers to a number of alleged incidents in which defendants treated Discon unfairly. Plaintiff alleges that "MECo forced Discon to accept obligations outside its contract, to forego billing job changes and to dispose of scrap on non-economic terms." Amended Complaint ¶ 38. Further, MECo executives "upbraided" Discon for dealing directly with NYT and disclosing the price of a removal job. Amended Complaint ¶ 41. Plaintiff also alleges that O'Reilly instructed Discon "to 'salt' scrap . . . by placing higher grade switches on top," Amended Complaint ¶ 74, and "directed Faltisco . . . to remove wire spring relays from scrap sold to AMAX [Copper]." Amended Complaint ¶ 75.

It further alleges that MECo discriminated against Discon and in favor of Technologies by allowing Technologies to use a prepaid billing system, Amended Complaint ¶ 35, and by awarding Technologies written contracts and authorizations for three jobs whose value exceeded one million dollars. Amended Complaint ¶ 37.

Discon also alleges that NYNEX and MECo participated in a scheme to defraud ratepayers by causing NYT to record overcharges in its regulated accounts, which enabled NYT to charge rates for local telephone service and exchange access that exceeded the rates it could maintain in the absence of the scheme to defraud. Amended Complaint ¶ 64.

Discon has deleted certain claims contained in the Complaint from the Amended Complaint: (1) a violation of 18 U.S.C. § 1962(a), which prohibits the investment in an interstate enterprise of income derived from a pattern of racketeering activity or through the collection of unlawful debt; (2) a violation of the New York Consumer Protection Act, N.Y. Gen. Bus. Law § 349; (3) a violation of the New York Public Service Law § 93; and (4) its third party beneficiary claim.

In addition to deleting certain claims, the Amended Complaint contains new allegations not raised in the Complaint, including allegations: (1) that Discon was injured as a NYT ratepayer by the alleged anti-competitive and racketeering acts of defendants, Amended Complaint ¶¶ 13, 124, 125; (2) that NYNEX showed favoritism to Technologies by entering into contracts for the purchase of high technology equipment and plug-in circuit boards, Amended Complaint ¶¶ 29, 33(b), 59, 61, 63, 72; (3) regarding NYNEX's disclosures to the Federal Communications Commission and the Securities Exchange Commission, Amended Complaint ¶¶ 67, 82; and

(4) regarding NYNEX's federal tax returns, Amended Complaint ¶ 87.

Finally, Discon alleges that, as a result of defendants' actions, it was forced to discontinue its business operations. It claims to be a victim of the same kind of anti-competitive conduct that led to the breakup of the old AT&T in the early 1980's and seeks damages in excess of $75,000,000.

B. Restraint of Trade Claim[3]

Section 1 of the Sherman Act provides that: "Every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1. The Sherman Act was enacted "for the protection of *competition*" in business and commercial transactions. *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962) (emphasis in original)). To state a claim under Section 1 of the Sherman Act, Discon must allege that: (1) the NYNEX defendants entered into a "contract, combination . . . or conspiracy"; and (2) that the conspiracy was "in restraint of trade or [interstate] commerce." *See International Distribution Centers, Inc.* v. *Walsh Trucking Co.*, 812 F.2d 786, 793 (2d Cir.), *cert. denied*, 482 U.S. 915 (1987).

The Fourth Count of the Amended Complaint purports to allege that, in violation of Section 1 of the Sherman Act, MECo and Technologies entered into an arrangement to fix

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3. Discon has re-arranged its Sherman Act claims in the Amended Complaint and now pleads its Section 2 claims first. Because the Court seeks to eliminate any confusion that might result, it will address Discon's Section 1 Restraint of Trade claims first, as it did in its Decision dismissing the Complaint.

prices and to restrict competition in the markets for removal services at NYT and in the New York State area; and that MECo and Technologies attempted to fix prices and restrict competition for other products and services purchased with funds from NYT's regulated accounts, such as transmission and switching equipment. Amended Complaint ¶ 110. Discon further alleges that MECo and AT&T conspired to exclude Discon from the market for removal services and agreed that NYT would not obtain removal services from Discon, but would obtain removal services from Technologies. Amended Complaint ¶ 33.

The Court finds that Discon fails to allege that defendants entered into an illegal contract, combination or conspiracy; or an actionable restraint of trade. The core of plaintiff's allegations remains the same as in the Complaint: that NYNEX and AT&T agreed to exclude Discon from NYT's removal service business and to award scrap removal service contracts to Technologies instead. The Court has already held that this allegation fails to state a claim under § 1 of the Sherman Act because the facts alleged show only a "vertical" arrangement between a buyer of services, the NYNEX companies, and a seller of services, Technologies and not a "horizontal" division of a market between competitors. Decision, at 10.

In an effort to fix its Section 1 claim Discon now alleges that NYNEX and AT&T:

> created a horizontal combination whose object was to exclude new entrants from the monopolized market for removal services, to maintain high price levels in this market, and to recover these administered prices through regulated rates for telephone service.

Amended Complaint ¶ 29.

The fact that NYNEX, NYT and MECo were purchasers of Discon's services and not competitors of Discon is fatal to Discon's Section 1 claim. Discon attempts to avoid this analysis by purporting to allege that MECo and Technologies were the dominant suppliers of removal services in the New York State area.[4] Amended Complaint, ¶ 29. Plaintiff fails, however, to allege any facts to support this conclusory statement. Moreover, in contradictory fashion, the Amended Complaint admits that "MECo's primary business function is procuring goods and services for New York Telephone and New England Telephone, and for NYNEX Service Company . . ." Amended Complaint, ¶ 16 and that MECo served as the intermediary between NYT and Discon. *See* Amended Complaint, ¶¶ 3, 40, 44. Because the Court finds that MECo and Discon were not competitors in the scrap removal market, it finds that this is not a case of horizontal price fixing and dismisses Discon's Section 1 claim.

The Second Circuit has stressed that when a firm stops purchasing from one supplier and starts purchasing from another, "the fact that an agreement between the buyer and the new supplier is necessarily involved does not make it an illegal conspiracy" under the Sherman Act. *Nifty Foods Corp.* v. *Great Atl. & Pac. Tea Co.*, 614 F.2d 832, 841 (2d Cir. 1980) (citations omitted). The Supreme Court has held that the Sherman Act permits a company to announce that it will do business only with companies that acquiesce to certain nonprice conditions and to refuse to do business with those

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4. The Court notes that this allegation is inconsistent with the facts plead by Discon in the Complaint: that MECo procured scrap removal services for NYT. *See* Complaint, ¶¶ 13, 51, 54.

who fail to comply. *See, e.g., Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984); *United States* v. *Colgate & Co.*, 250 U.S. 300, 307 (1919). Section 1 of the Sherman Act will only be implicated when there is a conspiracy with other parties "in an effort to force [a seller] to comply with fixed prices." *Pants 'N' Stuff Shed House, Inc.* v. *Levi Strauss & Co.*, 619 F. Supp. 945, 947 (W.D.N.Y. 1985).

There is no factual allegation in the Amended Complaint of a conspiracy to force a seller to comply with fixed prices. *Pants 'N' Stuff Shed House, Inc.*, 619 F. Supp. at 947. Rather, Discon realleges what it claimed in the Complaint, that NYNEX announced in advance that it would only do business with companies that dealt with MECo rather than with NYT directly, and that it refused to do business with those who failed to comply with this condition. This Court already determined that this is a nonprice condition that does not violate Section 1 of the Sherman Act, so long as it was implemented independently. Decision, at 11; *Monsanto*, 465 U.S. at 761; *see also Westchester Radiological Assocs. P.C.* v. *Empire Blue Cross & Blue Shield, Inc.*, 707 F. Supp. 708, 713 (S.D.N.Y. 1989) (seller has no antitrust claim when a buyer with market power "insists upon buying his services through an intermediary"), *aff'd on opinion below*, 884 F.2d 707 (2d Cir. 1989), *cert. denied*, 493 U.S. 1095 (1990). Moreover, the Amended Complaint nowhere indicates what prices other than those paid by defendants for services they themselves purchased were supposedly "fixed." In the absence of any effect on prices besides those paid by defendants, there can be no claim of price fixing. *Toys "R" Us, Inc.* v. *R.H. Macy & Co.*, 728 F. Supp. 230, 233 (S.D.N.Y. 1990) (no price-fixing claim when all that was alleged was agreement with manufacturers to fix retailer's own prices).

A company "of course generally has the right to deal, or refuse to deal, with whomever it likes, as long as it does so independently." *Monsanto*, 465 U.S. at 761. The Court directed Discon that in order to succeed on its Section 1 restraint of trade claim, it must be prepared to prove, through direct and circumstantial evidence, facts tending to exclude the possibility that NYNEX's conduct was unilaterally undertaken. Decision, at 11.

Plaintiff no longer alleges that NYNEX and MECo refused to do business with Discon because it inherently threatened to expose MECo's alleged excessive markups to NYT. Instead, in an effort to comply with the Court's directive, plaintiff has set forth a number of allegations attempting to exclude the possibility that NYNEX acted unilaterally in choosing Technologies rather than Discon for scrap removal services. Amended Complaint, ¶33. The Amended Complaint also alleges, however, that NYNEX did have an independent reason for choosing Technologies rather than Discon as a supplier. Plaintiff claims that, after mid-1985, MECo increased its profits by using high-cost vendors, such as Technologies, rather than Discon. Amended Complaint, ¶51. Thus, the Court finds that Discon has failed to plead specific facts that rule out the possibility that NYNEX acted unilaterally in choosing Technologies over Discon. The failure to specify what concerted actions NYNEX and AT&T took to further their alleged goal requires dismissal of plaintiff's Sherman Act §1 claim. *Telectronics Proprietary Ltd.* v. *Medtronic, Inc.*, 687 F. Supp. 832, 837 (S.D.N.Y. 1988); *see also Eastway Constr. Corp.* v. *New York*, 762 F.2d 243, 250 (2d Cir. 1985).

Finally, Discon attempts to allege a conspiracy between MECo and AT&T to restrain trade in the market for other

goods and services, such as transmission and switching services, Amended Complaint, ¶ 110, markets in which Discon does not compete. Discon alleges that it has standing to complain of antitrust violations outside of the scrap removal market because, as a telephone ratepayer, it paid higher rates as a result of this alleged conspiracy. Such a claim, however, is barred by the filed rate doctrine, which bars suits against regulated utilities grounded on the allegation that the rates charged by the utility are unreasonable. The doctrine holds that any filed rate, that is, one approved by the governing regulatory agency, is per se reasonable and, therefore, not challengeable in judicial proceedings brought by ratepayers. *Keogh* v. *Chicago & Northwestern Ry. Co.*, 260 U.S. 156 (1922); *see also, Square D Co.* v. *Niagara Frontier Tariff Bureau*, 476 U.S. 409 (1986); *Wegoland Ltd.* v. *NYNEX Corp.*, 27 F.3d 17 (2d Cir. 1994).

Accordingly, for the reasons stated, to the extent that Discon attempts to state a Sherman Act § 1 claim based on its standing as a ratepayer, its claim is dismissed.

C. Monopoly Claims

Section 2 of the Sherman Act provides that: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ." 15 U.S.C. § 2.

The First and Second Counts of the Amended Complaint purport to allege that NYNEX, NYT and MECo attempted to monopolize and did monopolize the market for removal services at NYT and in the New York State area. Amended Complaint, ¶¶ 100-102, 104-105. The Third Count of the

Amended Complaint purports to allege that NYNEX, NYT and MECo conspired among themselves and with Technologies to monopolize the market for removal services at NYT and in the New York State area. Amended Complaint, ¶¶ 106-108. The Court addresses these theories *seriatim*.

1. Attempted Monopolization

The elements of attempted monopolization under Section 2 are: "(1) anticompetitive or exclusionary conduct; (2) specific intent to monopolize; and (3) a dangerous probability that the attempt will succeed." *Volvo N. Am. Corp.* v. *Men's Int'l Professional Tennis Council*, 857 F.2d 55, 73-74 (2d Cir.) (citations omitted), *cert. denied*, 487 U.S. 1219 (1988).

The Court dismissed Discon's attempted monopolization claim in the Complaint because Discon failed to allege specific intent to monopolize. Specific intent to monopolize is a necessary element of a claim based on attempt to monopolize, *id.*, and generalized allegations of intent are insufficient. *Cf. United States* v. *Consolidated Laundries Corp.*, 291 F.2d 563, 572 (2d Cir. 1961); *Blaine* v. *Meineke Discount Muffler Shops, Inc.*, 670 F. Supp. 1107, 1110-11 (D. Conn. 1987).

Discon now alleges in the Amended Complaint that:

> NYNEX Corp., NYT and MECo attempted to monopolize the markets for removal services at NYT and in the New York State area. NYT has market power by virtue of its local telephone monopoly. NYNEX Corp. and MECo specifically intended to use this market power to exclude competition from the markets for removal services. There was a dangerous probability that their attempt would succeed, and it did succeed.

Amended Complaint, ¶ 100.

The Amended Complaint does not contain the necessary allegations of specific intent to monopolize. Discon cannot save its attempted monopoly claim by adding a conclusory statement of specific intent to its prior claim of attempted monopoly. In order to withstand a motion to dismiss, Discon must allege some conduct permitting an inference of specific intent to monopolize. *Blaine*, 670 F. Supp. at 1110. Bare bones allegations without supporting facts cannot support its claim of specific intent. *See TV Communications Network, Inc.* v. *Turner Network Television, Inc.*, 964 F.2d 1022, 1026 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992); *Heart Disease Research Found.* v. *General Motors Corp.*, 463 F.2d 98, 100 (2d Cir. 1972). This is particularly true where, as here, Discon has already been given leave to amend its Complaint.

Discon's attempted monopolization claim also must fail because, as the Court already ruled, there cannot be a "dangerous probability" of monopolization if a defendant does not compete in the same market as plaintiff. Decision at 16-17; *Capital Imaging Assocs. P.C.* v. *Mohawk Valley Medical Assocs.*, 725 F. Supp. 669, 678 (N.D.N.Y. 1989) (where defendants do not compete in same market as plaintiff "not only is there no *dangerous probability* that defendants will succeed in monopolizing the markets identified by plaintiff, there is no present *possibility* defendants will do so.") (emphasis in original); *see International Distribution Centers, Inc.*, 812 F.2d at 790-91; *Nifty Foods Corp.*, 614 F.2d at 841; *Soap Opera Now, Inc.* v. *Network Publishing Corp.*, 737 F. Supp. 1338, 1347 & n.12 (S.D.N.Y. 1990) (no probability of defendant monopolizing a market in which it did not compete); *Theater Party Assocs., Inc.* v. *Shubert Org.*, 695 F. Supp. 150, 156 (S.D.N.Y. 1988).

The Court has already determined that the Amended Complaint has failed to allege that defendants compete in the same market as Discon. Rather, as previously stated, the Amended Complaint admits that NYT and MECo were purchasers of the network removal services supplied by Discon. *See* [p. 29a *supra*]. Thus, Discon cannot adequately allege a dangerous probability that defendants would succeed in attempting to monopolize network removal services at NYT and in the New York State area. Accordingly, there can be no viable attempt to monopolize claim, and the Court dismisses Discon's Section 2 claim for attempted monopolization.

2. Monopolization

The elements of monopolization under Section 2 are: "(1) the possession of monopoly power in the relevant market; and (2) the willful acquisition or maintenance of that power, as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Volvo N. Am. Corp.*, 857 F.2d at 73.

The Court dismissed Discon's monopolization claim in the Complaint because defendants did not participate as competitors in the same market as Discon. Complaint, at 14. (citing *FLM Collision Parts, Inc.* v. *Ford Motor Co.*, 543 F.2d 1019, 1030 (2d Cir. 1976) (Section 2 claim dismissed because defendant did not compete in relevant market), *cert. denied*, 429 U.S. 1097 (1977)).

The Amended Complaint attempts to correct this failing by alleging:

> NYT has market power by virtue of its local telephone monopoly. NYNEX Corp. and MECo specifically intended to use this market power to exclude

competition from the markets for removal services.

Amended Complaint, ¶ 100.

As the Court has previously stated, the Amended Complaint admits that MECo's "primary business function" is procuring goods and services for NYT and NET. Amended Complaint, ¶ 16. The fact that Discon and defendants did not participate in the same market as competitors is fatal to Discon's monopolization claim. *See Official Airline Guides, Inc.* v. *FTC*, 630 F.2d 920, 926 (2d Cir. 1980) (rejecting monopolization claim because defendant "is engaged in a different line of commerce" than the market allegedly affected), *cert. denied*, 450 U.S. 917 (1981); *FLM Collision Parts, Inc.*, 543 F.2d at 1030; *Addino* v. *Genesee Valley Medical Care*, 593 F. Supp. 892, 901 (W.D.N.Y. 1984) (alternative ground for dismissal of Section 2 claim was that defendant was not a competitor of plaintiffs); *see also*, *White* v. *Rockingham Radiologists, Ltd.*, 820 F.2d 98, 104-05 (4th Cir. 1987) (hospital and plaintiff neurologist did not compete); *Mercy-Peninsula Ambulance, Inc.* v. *County of San Mateo*, 791 F.2d 755, 759 (9th Cir. 1986) (rejecting ambulance company's challenge to a county's award of exclusive contract to competitor because county was not a competitor in the market for healthcare provision).

Nor has Discon set forth any allegation that defendants tried to enter the market for removal services or attempted to use NYT's position in the telephone service market to gain monopoly power in the removal services market.

Thus, for the reasons set forth, the Court dismisses Discon's Section 2 monopolization claim.

3. Conspiracy to Monopolize

The elements of a conspiracy to monopolize claim are: "(1) concerted action; (2) overt acts in furtherance of the conspiracy; and (3) specific intent to monopolize." *Volvo N. Am. Corp.*, 857 F.2d at 74. The Court dismissed Discon's conspiracy to monopolize claim in the Complaint because it failed to allege any concerted action and failed to allege specific intent to monopolize. Decision, at 17.

The Amended Complaint attempts to correct these deficiencies by listing the purported acts of the alleged conspiracy. Amended Complaint, ¶ 107. The Court has already determined that the acts alleged by Discon fail to exclude the possibility that NYNEX acted on its own. Thus plaintiff has failed to establish the first element of its conspiracy to monopolize claim. The failure to specify what concerted actions NYNEX and AT&T took to further their alleged goal requires dismissal. *Telectronics*, 687 F. Supp. at 837; *Eastway Constr. Corp.*, 762 F.2d at 250. Finally, the failure of Discon to allege specific intent to monopolize on the part of defendants also requires dismissal of its conspiracy to monopolize claim. *TV Communications Network, Inc.*, 964 F.2d at 1026; *Disease Research Found.*, 463 F.2d at 100.

Moreover, merely alleging that NYNEX and Technologies agreed that Technologies rather than Discon would provide network removal services for NYT is insufficient to state a claim under Section 1 of the Sherman Act. *Monsanto*, 465 U.S. at 761; *see also Burdett Sound, Inc.* v. *Altec Corp*, 515 F.2d 1245, 1249 (5th Cir. 1975) (No antitrust violation where a manufacturer contracts with a new distributor and terminates its relationship with former distributor, even if the effect of the new contract is to seriously damage the former

distributor's business). Discon cannot attempt to state a claim under Section 2 by merely attaching the label "conspiracy to monopolize" to the same conduct alleged under its Section 1 claim. *See Seagood Trading Corp.* v. *Jerrico Inc.*, 924 F.2d 1555, 1576 (11th Cir. 1991) (conspiracy to monopolize claim dismissed where it relied on same allegations as insufficient Section 1 claim); *see also American Tobacco Co.* v. *United States*, 328 U.S. 781, 788 (1946) ("Sections 1 and 2 of the Sherman Act require proof of conspiracies which are reciprocally distinguishable from and independent of each other although the objects of the conspiracy may partially overlap."); *Regency Oldsmobile, Inc.* v. *General Motors Corp.*, 723 F. Supp. 250, 269 (D.N.J. 1989) (dismissing Section 2 conspiracy claim and stating "[p]laintiff's conspiracy to monopolize claim appears to be its § 1 claim in disguise."). Accordingly, for the reasons set forth, Discon's conspiracy to monopolize claim is dismissed.

D. RICO Claims

The Fifth, Sixth and Seventh Counts of the Amended Complaint purport to allege that defendants are liable under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* ("RICO"). Amended Complaint, ¶¶ 114-141.

RICO provides a civil remedy for any person "injured in his business or property by reason of a violation of § 1962 of this chapter . . . ." 18 U.S.C. § 1964(c). Section 1962, in turn, is divided into four subsections each of which sets out a separate type of prohibited activity involving a "pattern of racketeering activity" or the collection of an unlawful debt. 18 U.S.C. § 1962. "Racketeering activity" is defined in the statute to include various federal and state criminal law offenses such as mail fraud, wire fraud, fraud in the sale of

securities, extortion and obstruction of justice. 18 U.S.C. § 1961(1). A "pattern of racketeering activity" consists of at least two predicate acts violating the criminal statutes listed in § 1961(1) within ten years of the claim, where the acts were related and amount to continuing criminal activity, or by their nature pose a likelihood of continuing criminal activity. *H.J. Inc.* v. *Northwestern Bell Telephone Co.*, 492 U.S. 229, 239 (1989). Allegations that a defendant has engaged in predicate acts of racketeering activity are necessary prerequisites for stating a claim under any subsection of Section 1962.

The Court dismissed the Complaint because Discon had "failed to plead the predicate acts of mail fraud, wire fraud and fraud in the sale of securities with the particularity required under Fed. R. Civ. P. 9(b) and . . . failed to allege facts stating a claim under any of the subsections of § 1962." Decision, at 19.

In the Amended Complaint, Discon purports to plead predicate acts of mail and wire fraud, fraud in the sale of securities, extortion and obstruction of justice. The Court finds that the Amended Complaint fails to correct the deficiencies identified by the Court in its Decision. Despite representations to the Court that it had gathered evidence supporting all of its allegations, including contemporaneous records of defendants' wrongdoing, affidavits from former employees and records of proceedings in front of the New York State Public Service Commission, Decision, at 23, Discon has failed to meet the particularity requirements of Rule 9(b) when pleading the predicate acts of mail fraud, wire fraud and fraud in the sale of securities. Further, although Discon no longer sets forth a claim under 18 U.S.C. § 1962(a), the Amended Complaint, like the Complaint, fails to allege facts

stating a claim under Section 1962(b), (c) or (d). Thus, the Fifth, Sixth and Seventh Counts in the Amended Complaint are dismissed.

1. Pleading Fraud With Particularity Under Fed. R. Civ. P. 9(b)

Discon has alleged five fraud-based predicate acts. *See* Amended Complaint ¶¶69, 73, 83, 85, 86. With the exception of ¶73, these paragraphs set forth claims substantially similar to those alleged in the Complaint, which this Court has already determined failed to identify or describe the alleged predicate acts with the specificity required by Fed. R. Civ. P. 9(b). Decision, at 18-24.

Rule 9(b) provides, in pertinent part, that:

> In all averments of fraud . . . the circumstances constituting fraud . . . shall be stated with particularity. Malice, intent, knowledge and other conditions of mind may be averred generally.

"Rule 9(b) is designed to provide the defendant fair notice of the plaintiff's claims, and to enable the defendant to prepare a suitable defense, protect his reputation or good will from harm, and reduce the number of strike suits." *O'Brien* v. *Price Waterhouse*, 740 F. Supp. 276, 279 (S.D.N.Y. 1990), *aff'd sub. nom. O'Brien* v. *National Property Analysts Partners*, 936 F.2d 674 (2d Cir. 1991). Because of the potential harms attendant to being labelled a racketeer, these aims are even more compelling in civil RICO actions. *See Lou* v. *Belzberg*, 728 F. Supp. 1010, 1024 (S.D.N.Y. 1990); *Philan Ins. Ltd.* v. *Frank B. Hall & Co.*, 712 F. Supp. 339, 344 (S.D.N.Y. 1989); *Harrison* v. *Enventure Capital Group*, 666 F. Supp. 473, 478 (W.D.N.Y. 1987).

The Second Circuit has imposed stringent pleading requirements on plaintiffs who make allegations of fraud. "[T]he 'complaint must adequately specify the statements it claims were false or misleading, give particulars as to the respect in which plaintiff[ ] contend[s] the statements were fraudulent, state when and where the statements were made, and identify those responsible for the statements.'" *McLaughlin* v. *Arthur Anderson*, 962 F.2d 187, 191 (2d Cir. 1992) (quoting *Cosmas* v. *Hassett*, 886 F.2d 8, 11 (2d Cir. 1989)); *see also DiVittorio* v. *Equidyne Extractive Indus.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (plaintiffs must specify the "time, place, speaker and content of the alleged misrepresentations."); *Luce* v. *Edelstein*, 802 F.2d 49, 54 (2d Cir. 1986). A plaintiff asserting mail fraud also must identify the purpose of the mailing within the defendant's fraudulent scheme. *McLaughlin*, 962 F.2d at 191 (citations omitted).

Further, the plaintiff must supply a factual basis for allegations of scienter that "give rise to a 'strong inference' that the defendants possessed the requisite fraudulent intent." *Beck* v. *Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988), *overruled on other grounds*, *United States* v. *Indelicato*, 865 F.2d 1370 (2d Cir. 1989) (en banc). The allegations must show a motive and a clear opportunity for committing fraud, or circumstances clearly indicating conscious participation in the fraud. *Beck*, 820 F.2d at 50; *O'Brien* v. *National Property Analysts Partners*, 719 F. Supp. 222, 226 (S.D.N.Y. 1989).

Where multiple defendants are charged, "the complaint should inform each defendant of the nature of his alleged participation in the fraud." *DiVittorio*, 822 F.2d at 1247. "[T]he wholesale naming of directors and officers of corporations without any indication of the role of the individual

defendants'' is not enough. *The Limited Inc.* v. *McCrory Corp.*, 645 F. Supp. 1038, 1043 n.10 (S.D.N.Y. 1986). Instead, ''specific allegations must be made with respect to each particular individual.'' *Leslie* v. *Minson*, 679 F. Supp. 280, 284 (S. D. N.Y. 1988).

In order to state a claim of mail fraud, plaintiff must allege: (1) the existence of a scheme to defraud; (2) defendants' knowing or intentional participation in that scheme; and (3) use of the interstate mails in furtherance of the scheme. *Beck*, 820 F.2d at 49.[5]

In addition, Rule 9(b) requires that the complaint allege specific facts that support any conclusory allegations that the misstatements complained of were intentionally fraudulent. *Beck*, 820 F.2d at 50.

Discon alleges that the predicate acts of racketeering included mail fraud, wire fraud and securities fraud. Amended Complaint, ¶¶ 69, 73, 83, 85, 86. The charges contained in each of these paragraphs fail to meet the particularity requirements of Rule 9(b). For example, ¶ 69 alleges that NYNEX Corp. and Eckenrode caused NYT to make a fraudulent transfer of more than $3 million in payments to an attorney. Plaintiff fails to specify when and where the transfer occurred or to whom the transfer was made, the manner in which the transfer was fraudulent or the purpose of the transfer in defendants' fraudulent scheme. *McLaughlin*, 962 F.2d at 192.

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5. Wire fraud is identical to mail fraud except for the substitution of use of interstate wire communications for use of the mails. *U.S. Soccer Properties, Inc.* v. *Aegis Group PLC*, 1992 U.S. Dist. LEXIS 11513, at *31 (S.D.N.Y. Aug. 4, 1992).

Discon purports to allege a scheme to defraud ratepayers including acts of racketeering associated with marking up and processing Discon's invoices and alleges approximately 80 acts of mail fraud and 90 acts of wire fraud. Amended Complaint ¶ 73. Discon fails, however, to provide any specific information regarding the alleged frauds. Instead, it has compiled a list of invoices, sent primarily from Discon to MECo, and resulting wire communications. Discon fails to identify what specific statements were made, the manner in which the statements were false or misleading, their connection or relation to particular defendants or the purpose of the mailings or transfers in the fraudulent scheme. *Id.* In the absence of any facts indicating that the invoices contained misrepresentations or were false or misleading, there is no indication that the invoices served any function other than to present a request for payment. Without more, Discon cannot allege mail or wire fraud based on the mailing of these invoices or the wire transfers. *O'Malley* v. *New York City Transit Auth.*, 896 F.2d 704, 707 (2d Cir. 1990) (''routine, innocuous, business communications'' cannot form the basis for a mail fraud charge); *Atlantic Gypsum Co.* v. *Lloyds Int'l Corp.*, 753 F. Supp. 505, 512 (S.D.N.Y. 1990) (dismissing complaint where paragraphs ''consist of little more than string citations to business communications on particular dates, whose contents even as described in the complaint seem unremarkable''; and where the paragraphs do not set forth the contents of any alleged misrepresentation) (quoting *DiVittorio* v. *Equidyne Extractive Indus.*, 822 F.2d 1242, 1247 (2d Cir. 1987)). Thus, the Amended Complaint fails to allege any predicate acts of mail fraud or wire fraud with the requisite particularity.

As to the alleged instances of securities fraud, *see* Amended Complaint, ¶¶ 83, 85, 86, Discon fails to identify

any statement in any particular report that was rendered misleading by the alleged omissions. Moreover, Discon has failed to set forth any reason why the allegedly false statements or omissions were fraudulent. Thus, the Amended Complaint fails to allege any predicate acts of fraud in the sale of securities with the requisite particularity.

The Court notes that Discon's claims for mail fraud, wire fraud and fraud in the sale of securities in the Complaint were dismissed for substantially the same reasons, in spite of the fact that Discon was put on notice as to what was required to plead properly its claims under the RICO statute. Decision, at 22-24.

Moreover, the allegations of fraud contained in the Amended Complaint do not allege the essential element of deception. The mail fraud statute requires some element of deception. *McLaughlin*, 962 F.2d at 192. This element is satisfied "where the mailing itself is misleading or where there is some other deception which the mailing serves." *Id.* at 193. None of the five fraud-based allegations alleges any deception directed at Discon. A RICO claim cannot be based on deception of others.

2. Extortion

Discon purports to allege predicate acts of extortion in violation of the Hobbs Act. Discon alleges that defendants forced it to accept obligations outside its contract, to "salt" scrap, and to "remove wire spring relays from scrap sold to AMAX (Copper)." Amended Complaint ¶¶ 38, 74, 75. Discon also alleges that defendants put it in fear of economic loss unless it participated in "unlawful conspiracies." Amended Complaint ¶ 89. In addition, Discon alleges acts of extortion by defendants that did not involve Discon or cause it any

injury. Amended Complaint ¶ 88.

In *Agency Holding Corp.* v. *Malley-Duff & Assocs., Inc.*, 483 U.S. 143, 152 (1987), the Supreme Court held that the four-year statute of limitations of the Clayton Act applies in all civil RICO actions. The Complaint in this action was filed on May 25, 1990. Thus, the purported Hobbs Act violations that occurred more than four years prior to the filing of the Complaint must be dismissed as time barred.[6]

With respect to the remaining act of extortion, Discon alleges that a MECo employee told Faltisco, on September 8, 1986, that he would not be allowed to work for MECo or NYT unless he signed a release and returned evidence of the illegal markups. Amended Complaint, ¶ 56. The Court dismisses this allegation as Discon has failed to allege an "obtaining of property" as required by 18 U.S.C. § 1951(b)(2). At most, the conduct alleged by Discon amounts to threats to terminate or to refuse to rehire Discon as a NYT supplier. Under the terms of the contract between NYNEX and Discon, NYNEX had the right to terminate or refuse to rehire Discon. *See* Amended Complaint, Exhibit 1. "The threat to do that which one is contractually permitted to do is not extortion, and cannot possibly fall within any imaginable criminal definition of extortion." *Zaro Licensing, Inc.* v. *Cinmar, Inc.*, 779 F. Supp. 276, 283 (S.D.N.Y. 1991) (citations omitted).

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6. These include Amended Complaint ¶ 38, undated; ¶ 74, September 1984; ¶ 75, November 2, 1984; ¶ 77, incorporating purported acts of extortion occurring on June 19, 1984; ¶ 89, incorporating above paragraphs.

3. Obstruction of Justice

It is an obstruction of the due administration of justice intentionally to influence or injure a juror or officer "in or of any court of the United States." 18 U.S.C. § 1503. To constitute an offense under this statute, the act must relate to a proceeding in a federal court of the United States. *Id.*; *O'Malley*, 896 F.2d at 707 (citing *United States* v. *Biaggi*, 853 F.2d 89, 104 (2d Cir. 1988)).

Each of the acts of obstruction of justice alleged in the Amended Complaint involve payments on the part of defendants to unspecified former employees and to Lawrence Friedman. Amended Complaint ¶¶ 91-94. There is no allegation that these payments relate to a federal court proceeding as required by § 1503. Thus, the Court dismisses Discon's obstruction of justice claim pursuant to 18 U.S.C. § 1503. Nor is obstruction of justice included as one of the generic state law crimes set forth in 18 U.S.C. § 1961(1)(A). *Id.*

4. No Standing as Ratepayer

Discon alleges that the conduct of NYNEX's affairs through a pattern of racketeering caused it to pay higher regulated telephone rates in an undetermined amount believed to be in excess of $1,800.00. Amended Complaint, ¶¶ 124, 135.

The Second Circuit has recently decided that suits by ratepayers brought pursuant to the civil RICO provisions are barred by the filed rate doctrine. *Wegoland Ltd.* v. *NYNEX Corp.*, 27 F.3d 17 (2d Cir. 1994). Thus, Discon cannot maintain its RICO claims against defendants based on its standing as a ratepayer. Accordingly, to the extent Discon alleges injury as a ratepayer due to the alleged fraud of defendants, those claims are dismissed.

5. Section 1962(b) Claim

The Sixth Count of the Amended Complaint purports to allege that NYNEX, MECo and Eckenrode violated 18 U.S.C. § 1962(b) by maintaining an interest in and control of NYT through a pattern of racketeering activity. Section 1962(b) states that it is unlawful to acquire or maintain an interest in, or control of, an enterprise through a pattern of racketeering activity or collection of an unlawful debt. 18 U.S.C. § 1962(b).

Discon's Section 1962(b) claim in the Amended Complaint is substantially the same as the claim in its Complaint, which the Court dismissed as time-barred. *See* Decision, at 25; *Agency Holding Corp.*, 483 U.S. at 152.

Although Discon purports to allege in the Amended Complaint that NYNEX maintained control of NYT through actions occurring after May 20, 1986, it does not dispute that NYNEX acquired its control or interest in NYT upon the divestiture of AT&T on January 1, 1984. Complaint, ¶23; Amended Complaint, ¶21, and that all acts required for the acquisition and maintenance of control of NYT occurred on January 1, 1984, more than four years before the filing of the Complaint.

In addition, Discon has failed to assert any injury as a result of defendants' maintenance of control of NYT that is independent or distinct from the predicate acts themselves. *Danielsen* v. *Burnside-Ott Aviation Training Ctr., Inc.*, 941 F.2d 1220, 1231 (D.C. Cir. 1991) (plaintiff must allege an "acquisition" injury, analogous to "the use or investment injury" required under § 1962(a) to show injury by reason of a § 1962(b) violation.) (citing *Old Time Enterprises, Inc.* v. *International Coffee Corp.*, 862 F.2d 1213, 1219 (5th Cir.

1989)); *see also Litton Indus. Inc.* v. *Lehman Bros. Kuhn Loeb, Inc.*, 709 F. Supp. 438, 452 (S.D.N.Y. 1989) (dismissing § 1962(b) claim for failure to establish "causal connection between defendants' interest or control and [plaintiff's] injuries"), *rev'd on other grounds*, 967 F.2d 742 (2d Cir. 1992). Thus, for the reasons stated, Discon has failed to state a claim under Section 1962(b).

6. Section 1962(c) Claim

The Fifth Count of the Amended Complaint purports to allege that NYNEX Corp., MECo, NYT, Eckenrode and O'Reilly conducted and participated in the affairs of NYNEX through a pattern of racketeering activity, in violation of 18 U.S.C. § 1962(c). Amended Complaint, ¶ 116.

To state a claim under Section 1962(c), a plaintiff must allege that the "persons" committing the RICO violation were distinct from the "enterprise" conducted unlawfully. *Bennett* v. *United States Trust Co.*, 770 F.2d 308, 315 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986).

The Second Circuit has recently held that a plaintiff cannot state a claim under Section 1962(c) and circumvent the distinctness requirement "by alleging a RICO enterprise that consists merely of a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant . . . ." *Riverwoods Chappaqua* v. *Marine Midland Bank*, 30 F.3d 339, 344 (2d Cir. 1994).

Here, Discon alleges that NYNEX Corp., MECo, NYT, Eckenrode and O'Reilly were "persons" participating in the affairs of the "enterprise," NYNEX, which includes NYNEX Corp. and each of its subsidiaries. Amended Complaint ¶¶ 115, 116. Because NYNEX owns MECo and NYT, Eckenrode is employed by NYNEX, and O'Reilly is employed by

MECO, there is complete identity between the "persons" and "enterprise" alleged. Thus, pursuant to *Riverwoods Chappaqua*, Discon's Section 1962(c) claim is dismissed. Unlike Discon's Section 1962(c) claim in the Complaint, this is not a situation "[w]here the overlap between the defendants and the alleged RICO enterprise is only partial . . . ." *Jacobson* v. *Cooper*, 882 F.2d 717, 720 (2d Cir. 1989); Decision, at 28.

7. Section 1962(d) Claim

The Seventh Count of the Amended Complaint purports to allege that defendants conspired and agreed to violate 18 U.S.C. § 1962(b) and (c), in violation of 18 U.S.C. § 1962(d). Amended Complaint, ¶¶ 137, 138.

First, Discon's RICO conspiracy claim must be dismissed because a claim cannot be made under § 1962(d) in the absence of stating a viable claim under § 1962(a), (b) or (c). *Leonard* v. *Shearson Lehman/Am. Express, Inc.*, 687 F. Supp. 177, 182 (E.D. Pa. 1988); *see also*, *Danielsen*, 941 F.2d at 1232. Since Discon's Sections 1962(b) and (c) claims have been dismissed for the reasons explained above, its § 1962(d) claim must necessarily fail.

Second, the Amended Complaint, like the Complaint, fails to specifically allege that defendants agreed to commit specific predicate acts. Decision, at 29, citing *Hecht* v. *Commerce Clearing House, Inc.*, 897 F.2d 21, 25 (2d Cir. 1990). Because Discon has failed to allege a factual basis for finding an agreement among defendants, its Section 1962(d) claim must be dismissed. *Id.*, at 26 n.4.

E. Failure to Comply with Fed. R. Civ. P. 8(a)

Fed. R. Civ. P. 8(a) requires that "[a] pleading which sets forth a claim for relief . . . shall contain . . . a short and plain statement of the claim showing that the pleader is entitled to relief . . . ."

The Court dismissed Discon's Complaint under Rule 8(a) stating that the "Complaint lacks any coherent organization and is unduly confusing and lengthy." Decision, at 38. Although there may have been some attempt by Discon to match the more than ninety paragraphs of factual allegations to its claims, the Amended Complaint, like the Complaint, is unduly confusing and lengthy and does not provide a clear and succinct statement of the claims. Accordingly, although defendants did not move for dismissal of the Amended Complaint under Rule 8(a), the Court finds that the Amended Complaint also should be dismissed for failure to comply with the requirements of Rule 8(a).

F. Dismissal of Plaintiff's State Law Claims

The Court's only basis of jurisdiction over Discon's state law claims is pendent jurisdiction.[7] As all of Discon's federal claims have been dismissed, the Court will exercise its discretion and decline to retain jurisdiction over Discon's state law claims. *Finley* v. *United States*, 490 U.S. 545 (1989); *United Mine Workers* v. *Gibbs*, 383 U.S. 715 (1966). Discon's state law claims are hereby dismissed pursuant to Fed. R. Civ. P. 12(b)(1).

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7. Because the Complaint was filed prior to December 1, 1990, the Court does not have jurisdiction based on supplemental jurisdiction, 28 U.S.C. § 1367.

G. Dismissal of Plaintiff's Federal Claims with Prejudice

Fed. R. Civ. P. 15(a) requires that "leave [to amend the complaint] shall be freely given when justice so requires." Rule 15(a) has been interpreted liberally, allowing for amendment unless circumstances exist such as "'undue delay, bad faith, futility of the amendment, and perhaps the most important, the resulting prejudice to the opposing party.'" *Richardson Greenshields Secur., Inc.* v. *Lau*, 825 F.2d 647, 653 n.6 (2d Cir. 1987) (quoting *State Teachers Retirement Bd.* v. *Fluor Corp.*, 654 F.2d 843, 856 (2d Cir. 1981)). If the district court does exercise its discretion to dismiss the complaint with prejudice, "refusal to grant leave must be based on a valid ground." *O'Brien*, 740 F. Supp. at 284 (quoting *Ronzani* v. *Sanofi S.A.*, 899 F.2d 195, 198 (2d Cir. 1990)).

The Court finds that dismissal of Discon's federal law claims against defendants should be with prejudice. Discon has already been granted one opportunity to amend its Complaint, and has failed to satisfy the requirements of Rules 9(b) and 12(b)(6), as well as Rule 8(a). The superficial nature of Discon's amendments, *e.g.*, adding labels and conclusory allegations to the same core claims contained in the Complaint, leads the Court to believe that a third pleading would merely duplicate the failings that have twice resulted in dismissal. Based on the expected futility of an additional amendment and on the costs and potential prejudice to defendants, the Court will not grant Discon the opportunity to file a third pleading in this case. *Posner* v. *Coopers & Lybrand*, 92 F.R.D. 765, 770 (S.D.N.Y. 1981), *aff'd*, 697 F.2d 296 (2d Cir. 1982) (dismissal with prejudice of amended complaint proper when court put plaintiff on notice of the deficiencies of the initial complaint and plaintiff failed to correct them in the amended pleading).

CONCLUSION

For the reasons stated, defendants' motion to dismiss the Amended Complaint for failure to state a claim is granted. Discon's claims brought pursuant to the Sherman Act, 15 U.S.C. §§ 1 and 2 and RICO, 18 U.S.C. § 1961 et seq., are dismissed with prejudice. The Court declines to exercise its discretion to retain jurisdiction over Discon's state law claims. Accordingly, the state law claims are dismissed for lack of subject matter jurisdiction pursuant to Fed. R. Civ. P. 12(b)(1). Defendants' motion for sanctions pursuant to Fed. R. Civ. P. 11 is denied.

IT IS HEREBY ORDERED that plaintiff's Attempt to Monopolize, Monopolization, and Conspiracy to Monopolize claims are dismissed, with prejudice.

FURTHER, that plaintiff's Restraint of Trade, RICO Conduct Enterprise, RICO Controlled Enterprise, and RICO Conspiracy claims are dismissed, with prejudice.

FURTHER, that plaintiff's state law claims based on the Donnelly Act, Prima Facie Tort, Breach of Contract, Common Law Defamation, and Civil Conspiracy, are dismissed pursuant to Fed. R. Civ. P. 12(b)(1).

FURTHER, that defendants' motion pursuant to Fed. R. Civ. P. 11 is denied.

FURTHER, that the Clerk of the Court is directed to enter judgment in favor of defendants.

IT IS SO ORDERED.

/s/ RICHARD J. ARCARA
HONORABLE RICHARD J. ARCARA
UNITED STATES DISTRICT COURT

Dated: June 7 , 1995

Order of the Court of Appeals Denying Rehearing

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURTHOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
Clerk

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 7th day of January one thousand nine hundred and ninety-

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Discon Incorporated

Plaintiff-Appellant,

v.

Nynex Corporation

Defendant-Appellee

Dkt No: 95-7673

[SEAL
UNITED STATES COURT OF APPEALS
SECOND CIRCUIT
FILED
JAN - 7 1997
GEORGE LANGE III, CLERK]

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellee Nynex Corporation, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED.

Order Denying Rehearing

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: /s/ BETH J. MEADOR
Beth J. Meador,
Administrative Attorney

Supreme Court, U.S.
FILED
MAY 5 1997
CLERK

No. 96-1570

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES COMPANY, and NEW YORK TELEPHONE COMPANY,

Petitioners,

vs.

DISCON INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

SAMUEL A. CHERNIAK, *of Counsel*
Counsel of Record
GELMAN & FEINBERG
551 Fifth Avenue
New York, New York 10176
(212) 557-0559

GEORGE J. NAVAGH
1110 Central Park Tower
37 Franklin Street
Buffalo, New York 14202
(716) 842-6230 ext. 22

Counsel for Respondent

May 2, 1997

26 pp

COUNTERSTATEMENT OF QUESTIONS PRESENTED

Where, in order artificially to inflate the costs incurred by a regulated utility, a non-regulated affiliate of that utility conspires with one of its two suppliers to drive the other, lower cost, supplier out of business:

1. May that conspiracy constitute a *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?

2. May that conspiracy violate Section 2 of the Sherman Act, 15 U.S.C. § 2?

STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Respondent Discon, Inc., has no corporate parent or subsidiary.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES COMPANY, and NEW YORK TELEPHONE COMPANY,

Petitioners,

v.

DISCON INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

Respondent, Discon, Inc. ("Discon"), respectfully submits this brief in opposition to the petition for a writ of certiorari.

Counterstatement of the Case

A. Background

This case comes before this Court on the reversal of a judgment dismissing the complaint. The case arose out of the fraud that petitioners perpetrated on the ratepayers of Petitioner NYNEX Corporation's ("NYNEX") wholly owned subsidiary, petitioner New York Telephone Company ("NYTel"), by having one of NYNEX's other wholly owned subsidiaries, petitioner Materiel Enterprises Company ("MECo"), buy goods and services that it resold to NYTel

at prices far above MECo's costs. NYTel recovered these inflated costs from its captive ratepayers. As part and parcel of this scheme, MECo conspired with one of its only two providers of turnkey central telephone office removal services to exclude its other, lower cost supplier, Discon, from the removal market.

The Second Circuit correctly treated this case as an unusual, if not unique, exception to the general rule that, absent an agreement as to price, vertical agreements are not subject to the *per se* rule. Indeed, this case is exceptional because: (a) it arose out of transactions among a regulated utility, its unregulated affiliate and an unaffiliated company; (b) Discon alleged that, as summarized by the Court of Appeals, "the intent and effect of [the combination at issue here] was entirely anti-competitive" (12a); and (c) this allegation was supported by two decisions of the Federal Communications Commission and by a decision of the New York Public Service Commission that the complaint cited, Joint Appendix ("J.A.") 120. The FCC, in a decision to which the Second Circuit referred in its opinion (5a), found, *inter alia*, that: "unreasonable markups and overcharges [were imposed] by MECO on sales of equipment, supplies, and services to NYT[el] and [New England Telephone]; [and] the two regulated telephone companies, in turn, recorded these artificially inflated costs on their regulated books of account, enabling the carriers to recover these costs from ratepayers through the ratemaking process." *In the Matter of New York Telephone Co.*, 5 FCC Rcd. 866 (1990).

In view of these three administrative decisions, the Second Circuit's skepticism as to the ability of "the NYNEX defendants ... to present some pro-competitive justification for choosing a more costly supplier in order to overcharge captive rate-paying customers," (12a) is understated. In

claiming that the decision below set forth "an entirely unsatisfactory and unpredictable rule of law" (Petition for Certiorari ["Pet."] 12) that "will lead to significant litigation and business uncertainty" (Pet. 2) and "lead to a flood of federal antitrust litigation seeking treble damages on behalf of jilted suppliers" (Brief *Amicus Curiae* 5), petitioners and *amicus* conflate business decisions that can at least colorably be claimed to have been taken for legitimate business reasons with the intentionally anti-competitive scheme that gave rise to this lawsuit, a scheme that has been adjudicated to have led to massive inefficiencies and harm to consumers. *See also, Proceeding on Motion of the Commission as to the Rates, Charges, Rules, and Regulations of New York Telephone Company*, 31 NY PSC 485, *aff'd*, 190 A.D. 2d 217, 597 N.Y.S.2d 760 (3d Dept. 1993) (finding that MECo's average charge to NYTel per central office removal, including both those performed by Discon and those performed by Tech, was $98,000, as compared to the $24,595 average cost for comparable removals that NYTel contracted for directly, disallowing $13.85 million from NYTel's then current rates and ordering $20 million per year of future rates to be subject to refund upon subsequent Commission decision).[1]

Thus, in seeking review by this Court, petitioners and *amicus curiae* have vastly overstated the breadth of the

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[1] In a Recommended Decision issued on November 18, 1996 in Case 90-C-0912, *Proceeding on Motion of the Commission to Investigate Transactions Among New York Telephone Company and Its Affiliates*, a New York Public Service Commission Administrative Law Judge recommended that unless, at one last opportunity to do so, NYTel justifies its payments to MECo and other affiliates, it be required to refund approximately $300 million to ratepayers and to reduce rates prospectively by $32 million per annum.

Second Circuit's decision. Although holding in this case that the District Court should decide on remand *whether* to apply a *per se* rule, the Second Circuit made it plain that it was not calling into question its earlier holding in *Oreck Corp.* v. *Whirlpool Corp.*, 579 F.2d 126 (2d Cir.) (*in banc*), *cert. denied*, 439 U.S. 946 (1978), that, in general, two-firm vertical combinations such as that between MECo and its high price supplier, should be viewed "as exclusive distributorship controversies" (12a) and be governed by the rule of reason.

B. The Complaint

Respondent Discon's complaint alleged, *inter alia*, that the NYNEX companies schemed, as described above, to foist exorbitant telephone rates on NYTel's customers, while funnelling supra-competitive profits to MECo, by having MECo resell to NYTel at markups of as much as 600 per cent the goods and services it purchased for NYTel (J.A. 112, 120-21, 125). As part and parcel of this scheme, the complaint alleged, MECo agreed with AT&T Technologies ("Tech"), a wholly owned subsidiary of AT&T, Inc., that MECo would grant Tech non-competitive contracts for central telephone office removal services in New York State--the specialized business in which Discon engaged--as well as preferential contractual terms, in exchange for which Tech would give MECo secret kickbacks, refrain both from disclosing its prices to NYTel and from contracting directly with NYTel and actively cooperate with MECo in driving Discon from the market (J.A. 112, 121-24).

The complaint alleged further that: (a) from mid-1984 through late 1985, Discon sometimes sold removal services directly to NYTel and sometimes to MECo (J.A. 124-27); (b) in retaliation for the direct sales to NYTel, MECo and

Tech colluded, *inter alia*, to have a former partner of Discon's owner write to NYNEX falsely accusing Discon of malfeasance, including theft on the job, for which accusation the individual was rewarded by being allowed for the first time to subcontract to Tech on removal jobs (J.A. 126-27); and (c) in mid-1986, MECo, acting, in part, on the basis of that defamatory letter, removed Discon from the list of approved vendors, thus barring Discon from selling removal services either to MECo or directly to NYTel (J.A. 127, 129). The complaint alleged that throughout the period from mid-1984 through mid-1986, senior managers of NYTel colluded with the scheme described above, while middle managers sought to hire Discon directly because they knew that its prices for central telephone office removals were very much lower than the grossly inflated prices charged by MECo for work performed by either Discon or Tech (J.A. 129).

The complaint also alleged that NYTel and AT&T were at all relevant times the dominant purchasers of removal services in the New York State area and that MECO and Tech were the dominant suppliers of removal services, with Tech performing all the removals needed by AT&T, as well as, through MECo, the lion's share of those needed by NYTel (J.A. 119-20).

C. The District Court Opinion

Insofar as is relevant here, the District Court dismissed respondent's claims under Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2, with prejudice, holding, as to the Section 1 claim, that because MECo had not been alleged to have performed removal services but only to have supplied them to NYTel by purchasing them for

NYTel's ultimate use, MECo had not competed with Discon, and, accordingly, Discon had failed to plead a horizontal conspiracy. The District Court also held that the allegation that Discon had been excluded from the market as part of the scheme on the part of the NYNEX companies and Tech to pass unwarranted costs onto NYTel's ratepayers through the ordinary process of cost-plus ratemaking failed to allege a conspiracy "to force [a seller] to comply with fixed prices." (30a) Finally, the District Court held that Discon had not pled "specific facts that rule out the possibility that NYNEX acted unilaterally in choosing [Tech] over Discon." (31a)

As to Discon's Section 2 claims, the District Court held, *inter alia*: (a) that because none of the NYNEX companies participated in the same market as Discon, they could neither monopolize nor attempt to monopolize that market; and (b) that Discon had failed adequately to plead a conspiracy to monopolize inasmuch as it had failed either to specify any concerted action on the part of Tech and MECo or to allege a specific intent to monopolize (37a).

D. The Decision of the Court of Appeals

Insofar as is relevant here, the Court of Appeals affirmed the District Court's dismissal of Discon's claims of price fixing, monopolization and attempt to monopolize but reversed as to Discon's claims of conspiracy to restrain trade and conspiracy to monopolize. The Court of Appeals viewed MECo as analogous to an in-house purchasing division of NYTel and, held, accordingly, that Discon had not pled a horizontal conspiracy. However, taking note of the FCC investigation of the scheme described above--which proceeding was settled, *inter alia*, by NYTel and New England Telephone agreeing to reduce their capital account

balances (on which they recovered depreciation costs from ratepayers) by $32.6 million, reduce their interstate revenue requirements by $35.5 million and make a "voluntary payment" of $709,500 each to the United States Treasury, *In re New York Telephone Co.*, 5 FCC Rcd. 5892 (1990), cited at 5a[2]--the court held that Discon's allegations of a conspiracy between MECo and Tech stated a Section 1 claim under the rule of reason, and that, although the conspiracy alleged was a vertical one, the allegations

> possibly [stated a claim] under the *per se* rule applied to group boycotts in *Klor's*, if the restraint of trade "has no purpose except stifling competition." *Oreck*, 579 F.2d at 131 (quoting *White Motor Co.* v. *United States*, 372 U.S. 253, 263 (1963)).

(13a).[3]

However, while noting that "the traditional rationale for applying the rule of reason to two-firm boycotts--the promotion of interbrand competition over intrabrand

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[2] The scale of the NYNEX companies' scheme is not immediately evident from these figures. The amount of MECo overcharges was in fact found to be $118.5 million, of which $80.6 million was charged by MECo for capital items, the cost of which could be recovered only as depreciation expenses. The reduction in capital balances together with the refund were calculated to make NYNEX's ratepayers whole for the excess amounts they had paid for interstate calls alone. *See, In the Matter of New York Telephone Co.*, 5 FCC Rcd. 866, 873 n. 27 (1990). The Court had also been referred to the New York Public Service Commission proceeding described above (J.A. 120-21).

[3] The Questions Presented by the Petition do not challenge the court's holding that Discon is entitled to a trial under the rule of reason.

competition--does not exist in this case," the Court of Appeals explicitly specified that it was "not decid[ing] at this point *whether* the District Court on remand should apply a *per se* rule" (13a n. 6) (*emphasis supplied*).

With regard to Section 2 of the Sherman Act, the Court of Appeals affirmed the dismissal of Discon's claims of monopolization and attempted monopolization on the basis of the court's conclusion that Discon had failed to allege that MECo competed with Discon in the same market. However, the Court of Appeals reversed the District Court's dismissal of the claim for conspiracy to monopolize, holding: (a) that Discon had sufficiently alleged that Tech competed with Discon and that the NYNEX companies had conspired with Tech and had performed overt acts intending to assist Tech in its monopolization of the market for removal services; and (b) that the requirement of specific intent was met by Discon's allegations that "MECo sought the dominance of [Tech] in order to ensure the suppression of other suppliers who would bypass MECo and deal with NYTel directly" (15a).

Petitioners' petition for rehearing and rehearing *in banc* was denied, with no judge requesting that a vote be taken on the suggestion for rehearing *in banc* (55a).

REASONS FOR DENYING THE WRIT

A. The Decision of the Court of Appeals Upholding Discon's Section 1 Claim Conflicts Neither with This Court's Decision in *Sharp* nor with Any Decision of a Court of Appeals and Is Consistent with This Court's Teachings on Applying the *Per Se* Rule

i. The Decision Below Does Not Conflict with *Sharp*.

In *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988), this Court held that because it was not shown in that case that an agreement between a manufacturer and a dealer to terminate another, "price cutter" dealer "without a further agreement on the price or price levels to be charged by the remaining dealer, almost always tends to restrict competition and reduce output," *Sharp*, at 726-27, that agreement should be examined under the rule of reason rather than under the *per se* rule. That holding was squarely based on this Court's longstanding economic analysis showing that: (a) a vertical intrabrand restraint may well stimulate interbrand competition by, *inter alia*, eliminating the problem of freeloading dealers; and (b) "*so long as interbrand competition existed*, that would provide a 'significant check' on any attempt to exploit intrabrand market power." *Sharp* at 725, quoting *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 52, n. 19 (1977) (*emphasis supplied*).

In decisive contrast to the instant case, neither *Sharp* nor *GTE Sylvania* (nor *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984)), nor any of the decisions of Courts of Appeal cited by petitioners in support of their § 1 argument) involved a vertical agreement between parties, where even one of those parties had market power. Indeed, the analysis in *Sharp* is explicitly predicated on the presence of interbrand competition, *Sharp* at 725, *i.e.*, the ability of consumers to substitute a different brand of the same product, *Sylvania* at 53 n. 19. Here, however, NYTel had, as it still has, a monopoly over its product, and Tech and MECo were alleged to have acted in concert to eliminate any competition in supplying removal services to NYTel. The

complaint alleged (J.A. 119-21) that NYTel and AT&T were the dominant consumers of removal services in the New York State area, that Tech performed all the removal work required by AT&T as well as most of that required by NYTel, and that Tech and the NYNEX companies sought to ensure that MECo would be not only, as it already was, the only purchaser of removal services for resale to NYTel but also the only direct seller of removal services to NYTel. Thus, the alleged agreement between MECo and Tech to bar Discon from the removal market sought to exclude, and did exclude, the company that alone competed with Tech to perform removals for NYTel and alone challenged the NYNEX companies' scheme to make MECo the sole seller of removal (and other) services to NYTel.[4] Accordingly, *Sharp* is not directly applicable to this case, and thus, contrary to petitioners' main argument, the decision of the Court of Appeals does not conflict with *Sharp*.

[4] Petitioners argue that Discon's complaint "alluded to several pro-competitive reasons for not dealing with Discon" (Pet. 13). Petitioners claim that these "reasons" "included" that Discon had made a loan that it did not expect to be repaid to Robert W. Zirkelbach, a MECo employee, and that "questions were raised about the honesty, quality and safety of Discon's work." Petitioners add that "[n]aturally, Discon's pleading did not admit that these reasons were valid" (Pet 13 n. 5). What Discon's complaint alleged with regard to these "reasons" is that the first was a falsehood that petitioners tried unsuccessfully to extort from Discon's owner in their attempt to frame Mr. Zirkelbach (J.A. 127-28) and that the second was a deliberate and orchestrated attempt by MECo and Tech to defame Discon immediately after a middle manager at NYTel had greatly increased the scope of a removal job for which Discon and NYtel had negotiated the price directly. *See* J.A. 126-27. To label as competitively motivated acts that were alleged to have been ploys in a scheme to eliminate competition is truly Orwellian Newspeak.

ii. The Decision Below Is Consistent with This Court's Teachings on Applying the *Per Se* Rule

In *Sharp*, this Court summarized its teachings on applying *per se* rules as follows:

> We have said that *per se* rules are appropriate only for "conduct that is manifestly anticompetitive," *id.*, at 50, that is, conduct "'that would always or almost always tend to restrict competition and decrease output,'" *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-290 (1985), quoting *Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19-20 (1979).

Sharp, at 723.

That eliminating all competition in supplying a regulated monopolist such as petitioner NYTel "almost always tends," *Sharp* at 726, to generate inefficiencies that harm consumers is clear from the history of the Bell Telephone companies when they were owned by AT&T and there was no actual competition to be eliminated, *i.e.*, prior to the divestiture of AT&T in 1984. *See, United States* v. *AT&T*, 552 F. Supp. 131, 163 (D.D.C. 1982) (local operating companies forced to buy from their non-regulated affiliate, Western Electric, "even though other manufacturers produced better products or products of identical quality at lower prices."); *See also, AT&T Co.* v. *United States*, 299 U.S. 232, 246 (1936) (upholding FCC requirement of just and reasonable rates and referring to "intercorporate relations that are matters of common knowledge"); *Lindheimer* v.

Illinois Bell Tel. Co., 292 U.S. 151, 165 (1934) (rate reduction justified by overcharges imposed by unregulated affiliate). As Areeda and Turner state:

> since the probabilities of significant adverse economic effects attending monopolization of an unregulated supply stage by a regulated monopoly seem peculiarly high, we would make it presumptively illegal.

P. Areeda and D. Turner, *Antitrust Law* ¶ 726.

It is difficult to imagine conduct more "manifestly anticompetitive" and more purposefully designed to contravene the Sherman Act's purpose of promoting "consumer welfare," *NCAA* v. *Board of Regents of University of Oklahoma*, 468 U.S. 85, 107 (*cites omitted*) (1984), than that alleged in Discon's complaint. The attempt, successful in this case, to eliminate competition so as to allow the unfettered passthrough of inflated costs to NYTel's ratepayers, with MECo and Tech sharing the resulting supra-market profits, was nothing short of an attempt to recreate the pre-divestiture relationship between the Bell Telephone companies and Western Electric, *i.e.*, the functional equivalent of precisely that "monopolization of an unregulated supply stage by a regulated monopoly" that Areeda and Turner would make presumptively illegal.

In view of the allegations of the complaint that petitioners' scheme was undertaken in order to create inefficiencies (J.A. 120) and the FCC and New York Public Service Commission decisions cited in the complaint, which found that, all too foreseeably, the scheme had succeeded on a spectacular scale, the holding of the Court of Appeals that the trial judge should decide whether to apply a *per se* rule

not only does not conflict with *Sharp* but is entirely consistent with the pro-competitive principles that *Sharp* articulated to govern the application of *per se* rules.

iii. The Decision Below Does Not Conflict with the Holdings of Other Courts of Appeal

None of the nine Courts of Appeal decisions that petitioners claim to be in conflict with the decision of the Second Circuit (Pet. 10 n. 4) held that a *per se* rule may not apply to a non-price-fixing vertical agreement. Although each of those courts refused to apply a *per se* rule to the situation before it, those situations differed markedly from that presented here. Indeed, of the nine, three affirmed a grant of summary judgment to defendants on the ground that plaintiffs had failed to prove any agreement at all, *Bailey's, Inc.* v. *Windsor America, Inc.*, 948 F.2d 1018, 1030-31 (6th Cir. 1991); *Terry's Floor Fashions, Inc.* v. *Burlington Industries, Inc.*, 763 F.2d 604, 611 (4th Cir. 1985); *Products Liability Insurance Agency, Inc.* v. *Crum & Forster Insurance Companies*, 682 F.2d 660, 662 (7th Cir. 1982); one affirmed the grant of summary judgment to defendant on the ground that the only agreement shown was an intracorporate agreement, *Ark Dental Supply Co., Inc.* v. *Cavitron Corp.*, 461 F.2d 1093, 94 n.1 (3d Cir. 1972); one reversed judgment for plaintiff on the ground that implementation of the vertical agreement that was proved "did not deprive plaintiff of an element necessary to compete," *Gough* v. *Rossmoor Corp.* 585 F.2d 381, 387 (9th Cir. 1978); one reversed judgment for plaintiff on the ground that plaintiff had failed to prove either an agreement or exclusionary or coercive conduct, *E.A. McQuade Tours, Inc.* v. *Consolidated Air Tour Manual Comm.*, 467 F.2d 178, 187 (5th Cir. 1972), *cert. denied*, 409 U.S. 1109 (1973); one was explicitly predicated on the presence of interbrand

competition, *Westman Commission Co.* v. *Hobart Int'l, Inc.*, 796 F.2d 1216, 1225 (10th Cir. 1986), *cert. denied*, 486 U.S. 1005 (1988); one reversed judgment for plaintiff because the vertical arrangement that was proved at trial supported a *per se* claim of tying but the trial had been litigated exclusively on a horizontal conspiracy theory, *Construction Aggregate Transp., Inc.* v. *Florida Rock Industries, Inc.*, 710 F.2d 752 (11th Cir. 1983) (reversing judgment for plaintiff and remanding for new trial); and one affirmed a grant of summary judgment to defendant because plaintiff had failed to show that dealer-inspired refusals to deal had "any predominantly anticompetitive effects...as a class," *Lomar Wholesale Grocery, Inc.* v. *Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 594 (8th Cir. 1987).

Not one of these decisions intimated, much less held, that a vertical agreement between two companies, each of which has dominant market power and both of which have a regulated monopolist as their ultimate customer, to eliminate all competition to both of them may not constitute a *per se* violation of Section 1. Thus, not one of these cases conflicts with the holding below.

B. The Decision Below Upholding Discon's Conspiracy To Monopolize Claim Does Not Conflict with *Sharp* or with Any Court of Appeals Decision.

Petitioners' argument that the Court of Appeals erred in holding that Discon's complaint states a claim for conspiracy to monopolize rests solely on their mischaracterization of the complaint. Discon did not allege, as petitioners would have it, that a buyer (MECo) agreed to use one supplier (Tech), instead of another (Discon) (Pet. 14-16), but, rather, that MECo and Tech actively colluded to bar Discon from selling its services to NYTel. Among the

collusive acts alleged was that, immediately after NYTel had greatly expanded a job for which it had negotiated the price directly with Discon, MECo and Tech arranged to have a letter defaming Discon sent to NYNEX (J.A. 126-27). MECo subsequently used this letter as a basis to decertify Discon as a vendor either to MECo or to NYTel (J.A. 127), and Tech rewarded the writer of the letter by for the first time allowing him to subcontract to Tech on removal jobs (J.A. 127). Had MECo (or NYNEX) simply chosen unilaterally, or even by prior agreement with Tech, to buy removal services for NYTel from Tech rather than from Discon, there would have been no need for this defamatory letter.

Petitioners also err in claiming that the Court of Appeals holding is based on "a theory not pleaded by Discon" (Pet. 14). Contrary to petitioners' claim, the complaint alleged, *inter alia*, that Tech was the exclusive supplier of removal services to AT&T and that, "[a]cting in concert with MECo, [Tech] has perpetuated its monopoly over the supply of removal services to [NYTel]" (J.A. 119).

C. The Decision of the Court of Appeals Is Correct for an Independent Reason

Discon argued below that it was the victim of a horizontal conspiracy on the part of MECo and Tech to exclude it from the removal market. Although the Court of Appeals acknowledged that whenever NYTel contracted directly with Discon, MECo "presumably would lose the opportunity to derive a commission [and that [t]herefore, in one sense, MECo could be considered, if not a supplier, at least a competitor with Discon and [Tech]" (9a), the Court "decline[d] to adopt this line of analysis for two reasons"

(*Id.*). These reasons were: (a) that MECo "by its very nature" sold removal services only to NYTel; and (b) that MECo and NYTel were affiliated (*Id.*). The Court of Appeals reasoned, on this basis, that had MECo been organized "as a purchasing department within NYTel, rather than as a separate corporate entity, it would be undisputed that MECo did not compete with Discon or [Tech]. We *believe*," the Court concluded, that "it would be incongruous to apply a different rule simply because MECo holds its own corporate charter. *Cf., Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 58-59 (1977) (courts in antitrust cases should eschew 'formalistic line drawing'" (*9a-10a*, emphasis supplied).

But MECo's separate corporate existence was far from a formalistic matter for NYNEX--or for Discon. The whole scheme, described above, of passing supra-market costs through to NYTel's ratepayers depended on MECo being incorporated separately from NYTel. Had MECo been a "purchasing department within NYTel," its costs would from the start have been scrutinized in NYTel rate cases, there would have been neither exorbitant markups on services bought nor secret rebates from Tech, and MECo would have had no reason to prefer to buy from higher cost Tech than from lower cost Discon. In short, Discon would have thrived rather than having been made to wither. Inasmuch as the antitrust laws deal with real world economic purposes and consequences, it cannot be ignored that the separate corporate existence of MECo was the linchpin of the scheme addressed by the FCC and New York PSC proceedings discussed above and that, but for the scheme made possible by MECo's separate corporate existence, petitioners would have had no reason to exclude Discon as a supplier of removal services.

Moreover, for the FCC the separate corporate existence of MECo and NYTel entailed obligations the breach of which was sanctionable. *See, In the Matter of New York Telephone Co.*, 5 FCC Rcd. 866, 869 (1988) ("NYNEX ... effectively established the regulated telephone companies [NYTel and New England Tel. Co.] as captive customers of MECo.")

Once MECo is seen to stand apart from NYTel, it is evident that both MECo and Tech competed with Discon in selling removal services to NYTel. That Tech collusively chose not to deal directly with NYTel but only to sell its services through MECo is irrelevant. Those, like Tech, who can readily shift into offering an alternative source for a product are in the same market as those already providing the product. Areeda & Turner, *supra*, ¶ 530. Nothing, other than its own collusion in petitioners' scheme, prevented Tech from bidding directly to NYTel. That MECo was not alleged to have performed removal services on its own is equally irrelevant. As the Court of Appeals recognized, MECo competed with Discon for "commissions," *i.e.*, it competed to be paid for providing removal work. MECo competed with Discon just as surely as Discon would still have competed (with MECo and Tech) had it subcontracted the physical labor of removals to a third party instead of performing the work itself. Accordingly, although the Court of Appeals declined to follow this analysis, Discon properly alleged a horizontal conspiracy on the part of MECo and Tech to exclude it from the removal market. On this basis, too, this Court should deny the writ.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Dated: May 2, 1997

Respectfully submitted,

Samuel A. Cherniak, *of Counsel*
Counsel of Record
Gelman & Feinberg
551 Fifth Avenue
New York, New York 10176
(212) 557-0559

George J. Navagh
1110 Central Park Tower
37 Franklin Street
Buffalo, New York 14202
(716) 842-6230 ext. 22

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IN THE

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OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES COMPANY, and NEW YORK TELEPHONE COMPANY,

Petitioners,

v.

DISCON INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, New York 10017
(212) 450-4192

EDWARD S. BLOOMBERG
KEVIN J. ENGLISH
PHILLIPS, LYTLE, HITCHCOCK, BLAINE & HUBER
One Marine Midland Center
Buffalo, New York 14203
(716) 847-8400

Counsel for Petitioners

May 14, 1997

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IN THE

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OCTOBER TERM, 1996

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Petitioners,

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DISCON INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

Respondent's Brief in Opposition ("Br. Opp.") avoids the critical question whether a two-firm vertical relationship can be characterized as a "group boycott" within the meaning of *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959). Indeed, except in its description of the decision of the court below (*see* Br. Opp. 7-8), respondent's brief does not even cite *Klor's* or mention the word "boycott." Similarly, respondent ignores the serious confusion which the holding of the court below, if unreversed, will introduce into the law of antitrust.

Instead, respondent tries to distinguish on irrelevant factual grounds the decisions of this Court and nine Courts of Appeals which hold that a vertical agreement is not a boycott, and argues that the decision below could have rested on alternative grounds, which have no support in precedent and

which were not accepted by the court below.

Particularly in light of the fact that respondent has not tried to defend the aberrant boycott holding of the court below, the Court should grant certiorari and summarily reverse the judgment below on the ground that it is contrary to *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988). In the alternative, the Court should grant certiorari and schedule briefing and argument.

I. The Factual Distinctions Urged by Respondent Do Not Eliminate the Conflict Between the Decision Below and the Contrary Holdings of This Court and Nine Courts of Appeals

In *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 730-31 & n.4, 734 & n.5 (1988), this Court held that the group boycott rule of *Klor's* applies only to horizontal agreements among competing firms (*see* Pet. 10-11). Respondent tries to distinguish *Business Electronics* on its facts by arguing that the defendant in that case had no market power (Br. Opp. 9-10). This attempted factual distinction cannot eradicate the direct conflict between the holding of this Court in *Business Electronics* that a group boycott must be a horizontal agreement, and the holding of the court below that a two-firm vertical agreement may be a group boycott (Pet. 11a-12a). In light of this direct conflict, this Court should grant certiorari to reverse the judgment below.

Respondent also tries to distinguish on their facts the decisions of the nine Courts of Appeals which are in conflict with the decision below (Br. Opp. 13-14). Again, asserted factual distinctions cannot do away with the direct conflict between the decision below and the holdings of nine other Courts of Appeals that a group boycott must be a horizontal agreement (*see* Pet. 10 n.4, summarizing and quoting the holdings of the nine Courts of Appeals).

Respondent argues that the facts it alleges support its conspiracy to monopolize claim (Br. Opp. 14-15). But respondent cites no case which has held that a buyer's choice of one supplier over another may be a conspiracy to monopolize. The holdings of this Court and other courts are to the contrary (*see* Pet. 14-16 & n.8).

II. The Alternative Theories Argued by Respondent, Which Were Not Accepted by the Court of Appeals, Cannot Support the Judgment Below

Instead of trying to defend the group boycott theory adopted by the court below, respondent tries to support the judgment below by advancing two alternative rationales, neither of which has any support in precedent, and neither of which was accepted by the court below.[1]

First, respondent argues that it is a *per se* violation of Sherman Act § 1 for a regulated monopolist to buy from a single supplier (Br. Opp. 11-13). There is no precedent which supports this remarkable proposition. Respondent cites (Br. Opp. 11-12) three cases dealing with purchases by the old Bell System from its own affiliates, and a suggestion in the original Areeda-Turner treatise that "monopolization of an unregulated supply stage by a regulated monopoly" should be "presumptively unlawful." 3 Phillip E. Areeda & Donald F.

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1. In another apparent attempt to avoid the group boycott issue, respondent argues that the court below held that there was a violation of Sherman Act § 1 under the rule of reason and, separately, a possible *per se* violation under *Klor's* (Br. Opp. 7 & n.3). This is incorrect. What the court below actually held was that there was a "two-firm group boycott" in this case, which might ultimately be judged under the *per se* rule or under the rule of reason (*see* Pet. 13a n.6). The Court of Appeals did not hold that there was a claim under the rule of reason separate and apart from its erroneous "two-firm group boycott" holding.

Turner, *Antitrust Law* ¶726e, at 218 (1978).[2] All of these citations, however, deal with a situation in which a regulated monopoly has integrated backward *through ownership* into a supply market. No such situation is involved here, because there is no ownership relation between AT&T Technologies and the NYNEX companies (*see* Pet. 4a). Absent such an ownership relation, no case has held that purchases by a regulated monopoly from a single supplier constitute an antitrust violation.

In a related vein, respondent suggests that a regulated company violates the antitrust laws when it overpays for goods or services (Br. Opp. 2-3, 6-7, 12-13). Again, this suggestion is unsupported by authority. The purpose of the antitrust laws is to protect competition, *e.g.*, *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487-88 (1977), not to serve as a price control law, a lowest-responsible-bidder statute, or a substitute for public utility regulation.[3] *See, e.g., Ehredt Underground, Inc.* v. *Commonwealth Edison Co.*, 90 F.3d 238, 240 (7th Cir. 1996), *cert. denied*, 117 S. Ct. 685 (1997); *Sitkin Smelting & Ref. Co.* v. *FMC Corp.*, 575 F.2d 440, 448 (3d Cir.), *cert. denied*, 439 U.S. 866 (1978).

Second, respondent argues that MECo should be recognized as a separate entity for antitrust purposes from its commonly-owned affiliates, NYNEX and NYT (Br. Opp. 15-17). The court below held to the contrary (Pet. 8a-10a), and this holding was required by *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 771 (1984), which held that

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2. This suggestion is not carried forward in the revised volume, 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶787b, at 282-83 (1996).

3. Indeed, as respondent admits (Br. Opp. 2-3, 6-7), there has been active scrutiny by regulatory commissions of alleged overpayments by the NYNEX companies.

companies under common ownership must be regarded as a single entity for antitrust purposes.

Thus respondent's alternative arguments are unavailing to avoid the questions presented by the petition herein, in particular the question whether a two-firm vertical agreement can be a "group boycott" within the meaning of *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959). As described in the *amicus* briefs of The Association of the Bar of the City of New York and the Consumer Electronics Manufacturers Association, this question is one of broad public importance. Certiorari should be granted to correct the holding of the court below.

CONCLUSION

For the reasons set forth above and in the Petition for a Writ of Certiorari, the Court should grant a writ of certiorari, and should summarily reverse the judgment of the United States Court of Appeals for the Second Circuit on the ground that it is contrary to *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988). In the alternative, the Court should grant a writ of certiorari and set the case down for briefing and argument.

Dated: May 14, 1997

Respectfully submitted,

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, New York 10017
(212) 450-4192

EDWARD S. BLOOMBERG
KEVIN J. ENGLISH
PHILLIPS, LYTLE, HITCHCOCK,
BLAINE & HUBER
One Marine Midland Center
Buffalo, New York 14203
(716) 847-8400

Counsel for Petitioners

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DISCON, INCORPORATED,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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SUPPLEMENTAL BRIEF FOR PETITIONERS

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
2445 M Street, NW
Washington, DC 20037
(202) 775-0184

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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SUPPLEMENTAL RULE 29.6 STATEMENT

Since the filing of the Rule 29.6 Statement in the Petition (at ii-iii), petitioner NYNEX Corporation has become a subsidiary of Bell Atlantic Corporation.

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SUPPLEMENTAL BRIEF FOR PETITIONERS

Just as the Second Circuit made up its own theories to replace Discon's, the Government has now refused to defend the stated grounds of decision below and instead, defending the judgment in part, advanced its own new theories. These new theories only heighten the need for review, for they are unprecedented, incorrect, and dangerous (as well as inevitably influential). In conflict with numerous precedents, they blur the critical line between horizontal and vertical agreements, seek to relax the burdens of challenging purely vertical nonprice agreements, and boldly propose extending antitrust law to mere regulatory problems (overcharging consumers), where no *competition* issue is present. As the leading treatise notes, this is a case of alleged regulatory fraud masquerading as an antitrust case. P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 1644'c, at 726-28 (Supp. 1997). Review is imperative to resolve the conflicts and to prevent the inevitable chill on efficient changes of suppliers caused by imposing increased litigation risks and costs even where, as here, there cannot be any proof of harm to competition.

Section 1 Conspiracy. 1. The Government agrees that the Second Circuit was wrong in expressly countenancing "group boycott" and *per se* standards for judging what is no more than a two-firm vertical nonprice agreement. SG Br. 12, 14-15. Though peculiarly reluctant to state clear standards directly, the Government does not dispute that only horizontal agreements can be "group boycotts," as numerous Circuits recognize (Pet. 9-10), and that this Court repeatedly has held that a nonprice vertical agreement is not subject to a *per se* standard but to ordinary rule-of-reason analysis. *State Oil Co. v. Khan*, 118 S. Ct. 275, 281 (1997); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); *Continental TV, Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977); U.S. Br. 15, *State Oil v. Khan* (under *Sylvania* "vertical non-price restraints should be judged under the rule of reason"). The Second Circuit's sole basis for reinstating Discon's Section 1 claim—that Discon may challenge the two-firm nonprice vertical agreement on a group boycott theory

and that, upon proof of some set of facts alleged in the Amended Complaint, this theory may give rise to *per se* liability—thus conflicts with decisions of this Court and other courts. The ruling should be reviewed and readily reversed, for the Government has advanced no sound reason for allowing this erroneous and harmful ruling nevertheless to stand.

2. The Government makes two procedural points, but neither supports denial of review. First, while " '[t]his Court reviews judgments, not statements in opinions' " (SG Br. 12), that principle applies only to dicta; it is not properly invoked to disregard a lower court's sole stated rationale, which sets binding precedent for the Circuit.[1] This Court routinely reviews a lower court's stated rationale and remands for consideration of other possible grounds, as it just did in *State Oil Co. v. Khan*. *See Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990) (summary reversal in antitrust case); *cf. Trest v. Cain*, 118 S. Ct. 478 (1997) (reversing court's adoption of grounds not argued by parties). Second, while this case comes to the Court from a reversal of an order dismissing a (detailed Amended) Complaint (SG Br. 7, 18-19), this Court has heard many antitrust cases in this posture.[2] Here, as in those cases, the precedential ruling on the legal adequacy of the facts alleged demands review because of its importance and inconsistency with other decisions. And unalleged facts are irrelevant: on a motion to dismiss, "[i]t is not . . . proper to assume that the

[1] *See Seminole Tribe of Florida v. Florida*, 116 S. Ct. 1114, 1129 (1996); *United States v. Ianniello*, 808 F.2d 184, 190 (2d Cir. 1986), *cert. denied*, 483 U.S. 1006 (1987).

[2] *E.g., Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993); *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322 (1991); *Hoover v. Ronwin*, 466 U.S. 558 (1984); *Associated General Contractors v. California State Council of Carpenters*, 459 U.S. 519 (1983); *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978); *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1978); *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186 (1974).

[plaintiff] can prove facts that it has not alleged or that the defendant has violated the antitrust laws in ways that have not been alleged." *Associated General Contractors*, 459 U.S. at 526.

3. The Government also urges denial of review based on its own effort to reformulate the Second Circuit's rationale. SG Br. 12-17. But no such recharacterization can erase the clear holding, confirmed by the express rejection of other Circuits' contrary views (Pet. App. 11a-12a), that *per se* condemnation is available for some vertical nonprice arrangements. *See Electronics Communications Corp. v. Toshiba America Consumer Prods., Inc.*, 129 F.3d 240, 244 (2d Cir. 1997) (*Discon* holds "that an agreement between a supplier and its purchaser that disadvantaged the supplier's competitor could constitute a violation of the antitrust laws, even a per se violation"); P. Areeda & H. Hovenkamp, *supra*, at 726, 727 (recognizing *per se* holding here). In any event, the Government's reformulation does not weaken the grounds for review.

Under the Government's version, a firm may incur antitrust liability and treble damages for its choice of supplier, even if no harm to competition is proven (mere allegations will suffice), unless the firm produces a "valid procompetitive justification." SG Br. 12-13, 16-17. But this formulation itself violates black-letter law requiring proof of anticompetitive effects to impose rule-of-reason liability for vertical nonprice agreements: "The plaintiff bears the burden of proving that a restraint has a substantial anticompetitive effect. Absent such an anticompetitive effect, the defendant need not proffer justifications for its conduct." ABA Section of Antitrust Law, *Antitrust Law Developments* 55 (4th ed. 1997) (footnotes citing decisions omitted). This bedrock principle protects free-market choices against the litigation costs and risks imposed by forcing businesses to justify their choices to government enforcers and courts in the absence of present or threatened market power.[3]

[3] To distinguish harm to competition from harm to competitors, the anticompetitive effects element of a rule-of-reason case requires

No precedent supports departing from this fundamental rule-of-reason standard for vertical nonprice agreements. The Government relies entirely on two decisions that suggest (without resting on) a truncated inquiry into market power in a narrow class of cases involving "naked" restrictions on competition between rivals, *i.e.*, collusive horizontal agreements, which might otherwise be illegal *per se*. *See* SG Br. 16 (citing *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), and *NCAA v. Board of Regents*, 468 U.S. 85 (1984)). But since *GTE Sylvania*, no such approach has been or could be applied to vertical nonprice agreements. *See U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 594-95 (1st Cir. 1993). Remarkably, the Government does not acknowledge that its reading of the Second Circuit opinion proposes for the first time to extend a burden-shifting "quick look" approach across the horizontal-vertical line. Nor does it explain how blurring that line could be squared with this Court's insistence on maintaining the line with clarity to preserve firms' freedom to choose suppliers and make other vertical agreements. *See Sharp*, 485 U.S. at 726, 730 & n.4.

The regulated monopoly setting provides less, not more, justification for weakening rule-of-reason requirements for challenging purchaser-supplier contracts. Regulated companies (or, more generally, businesses operating under cost-plus contracts) need freedom to change suppliers, or to enter into requirements contracts, at least as much as other companies.[4] Moreover, with regulators monitoring

proof of actual or threatened market power. *See SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 965-66 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 2600 (1995); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 229 n.11, 230 (D.C. Cir. 1986) (Bork, J.), *cert. denied*, 479 U.S. 1033 (1987); *Ball Memorial Hospital, Inc. v. Mutual Hospital Ins., Inc.*, 784 F.2d 1325, 1334-35 (7th Cir. 1986) (Easterbrook, J.).

[4] The government itself recognizes that, though "considered to enhance efficiency," "[v]irtually any requirements contract could be characterized as a 'two-firm vertical' agreement 'to discriminate in favor of one supplier over another' " and thus fall under the shadow of the Second Circuit's ruling. SG Br. 14 n.11 (quoting Pet. App. 12a).

the very sort of conduct alleged in the Amended Complaint (*see* Pet. App. 5a; SG Br. 3 n.2), the "need" for antitrust scrutiny is smaller. At the same time, under Discon's premise of pass-through of excess costs to captive ratepayers, the increased costs caused by the chilling of supplier changes are less easily avoided by downstream consumers. It is perverse to deter efficient input choices precisely where the adverse impact on consumers may be least escapable.

4. The Government's primary argument against review here is a brand new rule-of-reason theory. SG Br. 7-12. Such an alternative defense of the judgment does not justify disregard of the lower court's actual rationale. In any event, the Government's theory fails on its merits. No rule-of-reason standard can be met in this case, because no factfinder could reasonably find harm to " '*competition*, not *competitors*' " (*Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993)) in the market actually alleged—removal services bought by NYNEX, *not* telephone service sold by NYNEX.[5] The Government's radical new antitrust theory, deeming mere overcharges in the regulated telephone-service market legally sufficient, strongly magnifies the need for review.

The Government asserts: "[a]n agreement between a regulated monopolist and its supplier to exclude a competing supplier from the market, when that agreement has the purpose and effect of enabling the monopolist to evade regulatory scrutiny and exercise market power in a downstream market, violates Section 1 in the absence of

[5] Discon avoided alleging any restraint on competition in the telephone-service market, because this case has nothing to do with any rivalry between sellers of telephone service; the only market in which competition is alleged to be restrained is a market in which NYNEX was a buyer. Amended Complaint ¶ 3 (alleged combination is "to restrain trade in the *market for removal services* and other products and services *purchased by* telephone companies") (emphasis added), ¶ 59 (same), ¶ 110 ("to restrict competition in the *market for removal services* at [New York Telephone] and in the New York State area") (emphasis added).

any procompetitive justification." SG Br. 12. This standard boldly dispenses with any requirement of harm to competition in the market from which the competing supplier was allegedly excluded—here, the removal-services market. The Government, only briefly mentioning that market (SG Br. 9), thus tacitly concedes that no such requirement could be met here. The Government does not dispute that NYNEX did nothing to "exclude" Discon beyond favoring AT&T as a supplier. *See* Pet. 14 & n.6. No harm to competition (rather than competitors) could result unless the new supplier could obtain market power and then maintain it by keeping out lower cost rivals wishing to serve other buyers seeking the services. *See* note 3, *supra*; note 9, *infra*. Yet, buried in a footnote (SG Br. 9 n.8), the Government concedes that nothing is alleged about the role of other competitors, harm to other purchasers, or the existence of entry barries for this business (consisting of dismantling and disposing of telephone central office equipment). Moreover, any allegation of market-wide harm would be "inherently implausible," even "preposterous," for a reason explained by the Seventh Circuit in upholding dismissal of a complaint in *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1109, 1110 (7th Cir. 1984), *cert. denied*, 470 U.S. 1054 (1985): it makes no economic sense to say that NYNEX, the principal *buyer* in the market, was conferring power on AT&T, its supplier, to exploit NYNEX itself through excessive prices and curtailed output, especially when, under Discon's own theory, NYNEX had no incentive to limit removal services. Lacking necessary allegations and resting on an implausible theory, this suit should be dismissed to prevent misuse of Section 1 to erode firms' essential freedom to select suppliers. *See Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986); *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763 (1984).

Unable to identify relevant harm in the alleged market, the Government's regulatory-evasion theory rests entirely on alleged harm to consumers in the market for telephone service, even though this case contains no alleged restraint of competition in that market. The Government relies on

the assertions that "[a]n increase in consumer prices resulting from the exercise of market power is an anticompetitive effect" (SG Br. 8; *see id.* at 9 n.6 ("[t]he anticompetitive effect . . . is the *exercise* of market power")) and that Section 1 reaches "the exercise of market power . . . in a market different from the one in which the restraint was imposed" (*id.* at 9). But these claims are an insupportable and radical effort to extend antitrust law, which is concerned only with consumer harms brought about *through impairment of competition*, to other forms of alleged consumer exploitation (*e.g.*, fraud, regulatory evasion) that have noting to do with the hobbling of competitors, let alone competition.[6]

No support for the Government's theory can be found in its only cited authority, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984). Neither the majority nor the concurrence says that the exercise of lawfully possessed market power is "anticompetitive" absent impairment of rivals' opportunities to compete in the market allegedly restrained, and the case unmistakably involved alleged consumer harm *through impaired competition* (for anesthesiology services and for doctor-hospital affiliations).[7] Nor can the Government justify the dramatic results of its novel theory: any change of supplier by a regulated monopolist (or any cost-plus business), at least any change to a superficially more costly supplier, could give rise to a Section 1 claim by the displaced supplier,

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[6] *See Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991) (antitrust, unlike direct regulation, addresses only the competitive *process*); S. Breyer, *Regulation and Its Reform* 156-57 (1982) ("the antitrust laws differ from classical regulation both in their aims and in their methods"; antitrust laws "seek to create or maintain the *conditions* of a competitive marketplace rather than replicate the *results* of competition or correct for the defects of competitive markets").

[7] The Government's unfounded use of *Jefferson Parish* as a springboard for new liability without impairment of competition highlights the concerns behind Justice O'Connor's concurrence urging the adoption of a rule-of-reason standard for tying claims, including the requirement of a substantial threat of "market power in the tied-product market." 466 U.S. at 38.

requiring costly litigation over intent and effect. Efficient changes of supplier would be deterred, and antitrust courts would be embroiled in regulatory accounting and pricing issues in unfamiliar, unnecessary, and inappropriate ways. *Cf. Town of Concord*, 915 F.2d at 25-29.

Not just unsupported, the Government's theory conflicts with the decisions of numerous courts, including the Second Circuit, concluding that the *exercise* of market power is *not* anticompetitive. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 294 (2d Cir. 1979) ("setting a high price may be a use of monopoly power, but *it is not in itself anticompetitive*") (emphasis added), *cert. denied*, 444 U.S. 1093 (1980).[8] Overcharging consumers by exercising market power may present a regulatory problem, but it is not an antitrust problem absent impairment of rivals' opportunities. To the contrary, "the charging of a high price is, so far as potential competitors are concerned, an attracting rather than an excluding practice." *Marshfield Clinic*, 65 F.3d at 1413; *see Berkey*, 603 F.2d at 294.

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[8] *See Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 548-49 (9th Cir. 1991) (same), *cert. denied*, 503 U.S. 977 (1992); *Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic*, 65 F.3d 1406, 1412-13 (7th Cir. 1995) (Posner, C.J.) ("[T]he antitrust laws do not regulate the prices of natural monopolists. A natural monopolist that acquired and maintained its monopoly without excluding competitors by improper means . . . can therefore charge any price that it wants, for the antitrust laws are not a price-control statute or a public-utility or common-carrier rate-regulation statute.") (citations omitted), *cert. denied*, 116 S. Ct. 1288 (1996); *Williamsburg Wax Museum, Inc. v. Historic Figures, Inc.*, 810 F.2d 243, 252 (D.C. Cir. 1987) ("imposition of a high price is not, in and of itself, an anticompetitive act"); *Kartell v. Blue Shield of Mass., Inc.*, 749 F.2d 922, 927 (1st Cir. 1984) (Breyer, J.) ("Ordinarily, however, even a monopolist is free to exploit whatever market power it may possess when that exploitation takes the form of charging uncompetitive prices."), *cert. denied*, 471 U.S. 1029 (1985); *Trace X Chem., Inc. v. Canadian Indus., Ltd.*, 738 F.2d 261, 267-68 (8th Cir. 1984) ("[S]etting a high price is not in itself anti-competitive."), *cert. denied*, 469 U.S. 1160 (1985).

The Government's theory also conflicts with its own previous recognition that antitrust law reaches regulatory evasion only where competition is harmed. The Government told the D.C. Circuit in the Bell System litigation that regulatory evasion through cost-shifting from a competitive market to a regulated one is not a *competitive* concern unless it also results in the threat of market power in the unregulated market: it sharply distinguished regulatory evasion "that does not afford any possibility of creating market power and that raises no competitive concern" from regulatory evasion that leads to "market power in the unregulated market" and thus raises antitrust concerns.[9] The Government does not acknowledge its change of position.

In sum, the Government's assertion of a Section 1 theory based on harm in the telephone-service market indefensibly and dangerously confuses a regulatory problem with an antitrust problem. The leading treatise, not cited by the Government, makes this point. It criticizes the Second Circuit decision for "effectively turn[ing] a claim of fraud into an antitrust claim. For example, any seller under a cost-plus contract might secretly conspire with a supplier to provide goods at inflated costs, paying a secret rebate to the seller, and with the effect of excluding alternative suppliers. As in any case of fraud or misrepresentation, the result will be that the contracted-for good is more

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[9] "Avoiding such overcharges to ratepayers in the regulated monopoly market is a regulatory concern. Under some circumstances, cross-subsidization through cost misallocation can also be a competitive concern because a firm that can recover some of the costs of its competitive operations in the rate-regulated monopoly market by including those costs in the rate base can price below cost in the competitive market without losing money. If as a result of this cross-subsidization the monopolist succeeds in driving out its competitors and preventing new entry, it may be in a position to raise its prices to the detriment of consumers in the unregulated market. Thus, by exploiting its monopoly position in the regulated market to gain market power in the unregulated market, it may earn supracompetitive profits that regulatory constraints prevent it from earning in the market in which it has a monopoly." U.S. Br. 29, *United States v. Western Elec. Co.*, No. 87-5388 (D.C. Cir. Apr. 17, 1989).

costly and consumers are injured. But no antitrust violation is apparent unless this activity threatens monopoly in a properly defined relevant market." P. Areeda & H. Hovenkamp, *supra*, at 727.

Section 2 Conspiracy. The conspiracy-to-monopolize claim is a concerted-action Section 1 claim in a different guise and cannot succeed if, as here, there is no sustainable Section 1 claim. *See* Pet. 14 n.7. The Government does not dispute this nexus; nor, conspicuously, does it defend the Section 2 holding in this case. SG Br. 17-18. The decision concededly rests on the premise that Discon alleged "that petitioners intended to assist *AT&T* in securing monopoly power in the removal services market" (*id.* at 18 (emphasis added)), a theory made up by the Second Circuit after rejecting Discon's actual theory—that the conspiracy was to make a monopolist out of *NYNEX*, which was not even a seller in the market (Discon C.A. Br. 27; Discon C.A. Reply Br. 7). *See* Pet. App. 13a-14a. But the Government neither cites any precedent for nor defends the premise that the Section 2 conspiracy claim can rest on a theory that NYNEX conspired to give AT&T, a separate company, monopoly power over NYNEX itself as a buyer in the removal-services market, the very notion held to justify dismissal as "inherently implausible" and "preposterous" in *Car Carriers*, 745 F.2d at 1109, 1110. The Section 2 holding here should be reviewed along with the Section 1 holding to ensure that the same harms are not effected through an alternative route.

CONCLUSION

The Second Circuit's ruling warrants review and reversal. The Government has advanced no sound basis for defending or ignoring the court's actual grounds of decision. The Government's alternative theories—offered in partial support of the judgment—only add to the need for review, for, in disregard of compelling contrary authority, these radical new theories would harmfully extend the power of antitrust enforcement to intrude into the regulatory sphere. The petition for a writ of certiorari should be granted.

Respectfully submitted,

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
2445 M Street, NW
Washington, DC 20037
(202) 775-0184

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

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In the Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION, ET AL., PETITIONERS

v.

DISCON, INCORPORATED

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL TRADE COMMISSION AS AMICI CURIAE

SETH P. WAXMAN
Solicitor General
JOEL I. KLEIN
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
A. DOUGLAS MELAMED
Deputy Assistant Attorney General
BARBARA MCDOWELL
Assistant to the Solicitor General
CATHERINE G. O'SULLIVAN
MARK S. POPOFSKY
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

DEBRA A. VALENTINE
General Counsel
Federal Trade Commission
Washington, D.C. 20580

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QUESTIONS PRESENTED

1. Whether the court of appeals correctly held that a seller stated a claim under Section 1 of the Sherman Act, 15 U.S.C. 1, by alleging that it was excluded from the market as part of a conspiracy between a rival seller and their buyer, a regulated monopolist, to raise prices to the monopolist's customers by circumventing regulatory constraints.

2. Whether the court of appeals correctly held that an entity may conspire to monopolize, in violation of Section 2 of the Sherman Act, 15 U.S.C. 2, when it acts with the specific intent to assist another entity to acquire or maintain monopoly power.

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In the Supreme Court of the United States

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No. 96-1570

NYNEX CORPORATION, ET AL., PETITIONERS

v.

DISCON, INCORPORATED

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL TRADE COMMISSION AS AMICI CURIAE

This brief is filed in response to this Court's order inviting the Solicitor General to express the views of the United States.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 93 F.3d 1055. The opinion and order of the district court (Pet. App. 21a-53a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on August 26, 1996. A petition for rehearing and suggestion for rehearing en banc was denied on January 7, 1997. The petition for a writ of certiorari was filed on April 3, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Respondent Discon Incorporated (Discon) competed with AT&T Technologies (AT&T) in the market for "removal services" (salvage and disposal of obsolete telephone central office equipment) in the State of New York. Petitioner New York Telephone Company (NYT), a regulated subsidiary of petitioner NYNEX and the monopoly provider of local telephone exchange service throughout most of the State, is a user of removal services. During the period at issue, NYT purchased removal services principally through petitioner NYNEX Materiel Enterprises (MECo), an unregulated NYNEX subsidiary that served as a purchasing agent for NYNEX and its affiliates. Pet. App. 3a-4a.

According to Discon's complaint, from 1984 through at least 1986, petitioners and AT&T engaged in a conspiracy to overcharge NYT's customers for local telephone service.[1] MECo purchased removal services for NYT from AT&T at inflated prices. MECo then passed these prices on to NYT, which recovered them through the rates charged its customers. Those rates were set by state regulators based on NYT's cost of service. AT&T subsequently paid a secret year-end rebate that, in effect, reduced the prices that MECo paid for AT&T's services below the levels disclosed to state regulators. Pet. App. 4a-5a. Thus, as the court of appeals explained, petitioners "were able to generate increased revenues

[1] Because the court of appeals correctly treated NYNEX and its wholly owned subsidiaries, NYT and MECo, as a single antitrust entity in the circumstances presented by this case (see Pet. App. 8a-10a), we ascribe MECo's alleged conduct to NYNEX and NYT.

that were essentially derived from [NYT's] telephone monopoly," while avoiding "oversight from the state regulatory commission." *Id.* at 5a.

The complaint went on to allege that, in order to assure the success of the scheme, petitioners and AT&T conspired to exclude Discon from the removal services market. They did so because Discon not only refused to join in the scheme, but also engaged in acts that endangered the scheme's success, such as underbidding AT&T's inflated bids and, on occasion, selling removal services directly to NYT, thus bypassing MECo. Complaint ¶¶ 34, 40-45, 47, 52-55. In response, the complaint alleged, petitioners granted contracts to AT&T instead of Discon, even when Discon submitted a lower bid, and, in concert with AT&T, petitioners disseminated false information that led to Discon's decertification as an approved vendor for NYNEX affiliates. *Id.* ¶¶ 33-34, 50-55, 110. Because the conspirators and their affiliates were the dominant purchasers of removal services in New York State, Discon's exclusion from NYT's business caused it to cease operations. *Id.* ¶¶ 29, 55, 108, 113. See Pet. App. 5a-6a.[2]

[2] See *In re New York Telephone Co.*, 5 F.C.C.R. 866 (1990) (initiating enforcement proceedings against NYT for apparent violation of FCC rules in connection with "unreasonable markups and overcharges by MECO on sales of equipment, supplies, and services to NYT," which, "in turn, recorded these artificially inflated costs on [its] regulated books of account, enabling [it] to recover these costs from ratepayers through the ratemaking process"); 5 F.C.C.R. 5892, 5893 (1990) (consent decree whereby NYT agreed to refund more than $35 million for "unreasonable rates reflecting improper capital costs and expense charges" without admitting liability).

2. Discon brought suit against petitioners in May 1990 and, following dismissal of its original complaint, filed an amended complaint in July 1992. The amended complaint alleged, in relevant part, that the above-described conduct violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. 1, 2. See Pet. App. 6a.

In June 1995, the district court granted petitioners' motion to dismiss for failure to state a claim. With respect to the Section 1 claims, the court disagreed with Discon's contention that the alleged conspiracy between AT&T and petitioners could be characterized as an unlawful horizontal restraint or as vertical resale price maintenance. Pet. App. 28a-30a. The court further concluded that Discon's Section 1 claims failed because they did not adequately allege a conspiracy. *Id.* at 31a. The court also dismissed Discon's claims under Section 2 of the Sherman Act, holding that petitioners could not be held liable for monopolizing or attempting to monopolize the removal services market because they neither competed, nor sought monopoly power, in that market. *Id.* at 32a-36a. The court rejected Discon's conspiracy-to-monopolize claim both for this reason and for not adequately alleging a conspiracy. *Id.* at 37a-38a.

3. The court of appeals affirmed in part, reversed in part, and remanded for further proceedings. On the Section 1 claims, the court agreed with the district court that the relationship between petitioners and AT&T was not horizontal and that the complaint failed to allege resale price maintenance. Pet. App. 8a-10a & n.5. The court nonetheless reinstated

Discon's Section 1 claim, albeit on "a different legal theory than the one articulated by Discon." *Id.* at 7a.[3]

Citing *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the court concluded that an agreement among vertically situated parties, including one between a single supplier and a single purchaser, could be characterized as a "group boycott" if the agreement had a "horizontal market impact." Pet. App. 11a. In the court's view, Discon had alleged such a group boycott because, on the face of the complaint, no "pro-competitive rationale" was evident for petitioners' choice of AT&T over Discon. *Id.* at 12a. Indeed, Discon had alleged that "the intent and effect" of that choice was "entirely anti-competitive." *Ibid.* The court held that such allegations were sufficient, at the pleading stage, to state a rule-of-reason claim under Section 1. *Id.* at 13a. The court further suggested that the charged scheme might be unlawful *per se*, but only if it ultimately was judged to have had "no purpose except stifling competition." *Ibid.* (internal quotation marks and citation omitted). The court left the question whether a *per se* rule ought to be applied for the district court to address on remand after further factual development. *Id.* at 13a n.6.

Turning to Section 2, the court affirmed the dismissal of the attempted monopolization and monopolization claims. Pet. App. 13a-14a. But the court reinstated the conspiracy-to-monopolize claim after determining that Discon adequately alleged that petition-

[3] In a holding that petitioners do not contest, the court of appeals, reversing the district court, ruled that the complaint sufficiently alleged a conspiracy between AT&T and petitioners, thus satisfying Section 1's "concerted action" requirement. Pet. App. 7a n.3. See *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 767 (1984).

ers had specifically intended to secure AT&T's "dominance" in the removal services market. *Id.* at 15a. The court held that such allegations were sufficient to state a claim because "[a] defendant may be liable for conspiracy to monopolize where it agrees with another firm to assist that firm in its attempt to monopolize the relevant market." *Id.* at 14a.

DISCUSSION

In our view, the court of appeals' interlocutory ruling does not warrant review. The court's holding that Discon's complaint states a claim under the Sherman Act is correct and creates no conflict with decisions of this Court or other courts of appeals. We nonetheless acknowledge that certain language in the court's opinion was not well-chosen, such as the court's use of the term "group boycott" to characterize the conduct at-issue here. Despite its characterization of the challenged conduct as a "group boycott," the court did not hold that such conduct was perforce illegal under Section 1. Instead, the court emphasized the importance of assessing the procompetitive justifications and anticompetitive effects of such conduct, leaving it to the district court on remand to determine, upon further development of the record, whether rule of reason or *per se* analysis should ultimately govern the claim. Indeed, the court of appeals has since suggested that this case turned on its particular facts and does not state any general rule governing the analysis of exclusive dealing arrangements. See *Electronics Communications Corp.* v. *Toshiba America Consumer Prods., Inc.*, 129 F.3d 240, 244-245 (2d Cir. 1997). We therefore believe that review at this juncture would be premature. Any clarification of the standard governing application of

the Sherman Act to claims involving regulatory evasion schemes should await a lower court decision applying the law to a more fully developed record.

1. The court of appeals correctly reversed the district court's dismissal of Discon's claim that the vertical conspiracy between petitioners and AT&T violated Section 1 of the Sherman Act. It should be emphasized that the courts were assessing that claim at the outset of the case on a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6). This Court has repeatedly instructed that complaints, including antitrust complaints, are to be "liberally construed" at that stage, and "should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764, 811 (1993) (internal quotation marks omitted). A dismissal at the pleading stage is "especially disfavored" where, as here, the case presents "a novel legal theory that can best be assessed after factual development." *Baker* v. *Cuomo*, 58 F.3d 814, 818-819 (2d Cir.) (citing 5A Charles A. Wright, et al., *Federal Practice and Procedure* § 1357, at 341-343 (1990)), cert. denied, 116 S. Ct. 488 (1995).

Liberally construed, Discon's complaint alleges that petitioners and AT&T agreed (1) that petitioners would purchase removal services from AT&T at inflated prices, a portion of which would be returned to petitioners in the form of secret rebates, so that they could evade regulatory constraints on the pricing of local telephone services; and (2) that petitioners and AT&T would seek to exclude Discon from the market for removal services because its conduct threatened petitioners' ability to evade regulation and

thus overcharge NYT's customers (Complaint ¶ 41).[4] Such a conspiracy could cause anticompetitive effects in both the local telephone market and the removal services market.

The primary object of the alleged conspiracy was to garner for petitioners the very supracompetitive profits that state regulation of NYT's rates was designed to prevent.[5] According to the complaint, petitioners' and AT&T's agreement to exclude Discon, as part of their effort to avoid regulatory scrutiny, was designed to facilitate petitioners' exercise of market power over NYT's customers. An increase in consumer prices resulting from the exercise of market power is an anticompetitive effect of the sort that Section 1 is designed to prevent. See, *e.g.*, *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 13 n.19 (1984) (explaining that exercise of market power through tying arrangements has "anticompetitive effects" when "used to evade price control in the tying product through clandestine transfer of the profit to the tied product") (quoting *Fortner Enterprises, Inc.* v. *United States Steel Corp.*, 394 U.S. 495, 513 (1969) (White, J., dissenting)); *id.* at 35 & 36 n.4 (O'Connor, J., concurring) (acknowledging that tying arrangements may present antitrust concerns when they "abet the harmful exercise of market power that

[4] Although the complaint does not explain why Discon's continued participation in the market threatened the scheme's success, it may be that Discon's competing bids constrained the conspirators' ability to mask the regulatory circumvention.

[5] See generally Thomas G. Krattenmaker, *Telecommunications Law & Policy* 516 (1994) (explaining that inflating the price of equipment through an unregulated affiliate is a substitute, albeit an "imperfect" one, for a "straightforward monopolistic" price increase).

the seller possesses in the tying product market" by enabling the seller to evade price controls).[6] Although here the exercise of market power occurred in a market different from the one in which the restraint was imposed, that fact does not place a restraint beyond the reach of Section 1. See, *e.g.*, *Jefferson Parish*, 466 U.S. at 29-30 (noting that exclusive dealing arrangement may involve restraint in one market that causes anticompetitive effects in another market).[7]

The alleged agreement to exclude Discon also had the potential to distort competition in the market for removal services, thereby causing additional injury to consumers in the downstream telephone services market.[8] A monopolist, even if regulated, ordinarily

[6] The anticompetitive effect flowing from petitioners' and AT&T's scheme is the *exercise* of market power, and not its creation or augmentation. Section 1, however, is not concerned only with the creation and augmentation of market power. Section 1 condemns restraints that cause "detrimental effects," for which market power is "but a 'surrogate.'" *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 460-461 (1986) (quoting 7 Phillip E. Areeda, *Antitrust Law* ¶ 1511, at 429 (1986)).

[7] Absent unusual circumstances, when an exercise of market power produces higher consumer prices, a decrease in output will also occur. Thus, petitioners' and AT&T's alleged agreement to exclude Discon, by enabling petitioners to raise their "monopoly profits over what they would be absent the [restraint]," undesirably "increase[d] the social costs of market power." *Jefferson Parish*, 466 U.S. at 14-15 (discussing tying that facilitates price discrimination); *id.* at 36 n.4 (O'Connor, J., concurring) (acknowledging that tying arrangements may violate Section 1 when they decrease output).

[8] In certain circumstances, a purchaser's agreement to exclude a supplier of particular goods or services might also harm other purchasers of those goods or services. Discon, however, did not expressly allege such an effect. It identified NYT and

has an incentive to purchase from the supplier who offers the lowest price, because that enables the monopolist to maximize its profits by lowering its costs and increasing its sales. That incentive is aligned with the interests of consumers. A regulatory circumvention scheme could change that alignment. The regulated monopolist then will also consider whether, and to what extent, a supplier will assist it in evading regulation and exercising market power in the regulated market. The monopolist may select the supplier best suited to evade regulation, even if it is not the one charging the lowest price, because the monopolist may prefer to incur higher costs in order to extract supracompetitive profits. Consumers then may suffer injury not only from the downstream exercise of market power, but also from the actual increase in costs attributable to the monopolist's selection of an inefficient supplier.[9]

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an AT&T affiliate as the "dominant purchasers of removal services" in New York State, and alleged that one object of the alleged conspiracy was to "maintain high price levels" in the removal services market (Complaint ¶ 29). Discon further alleged that AT&T was the dominant supplier of removal services in New York State (*id.* ¶ 26), but did not indicate whether Discon was the only other supplier. Nor does the complaint contain express allegations concerning the prospects for entry or minimum efficient scale, although it does allege that Discon was driven from the market when it lost petitioners' business.

[9] This point is illustrated by a simple example: Assume that Discon could provide removal services at a cost (including competitive return on investment) of $1,000, and that AT&T could provide the same services at a cost of $1,100. Further, suppose that AT&T, but not Discon, was willing to participate in a scheme to evade regulation. Under these circumstances, petitioners would be likely to deal only with AT&T despite its

Such injuries to consumers also fall within the reach of Section 1. As this Court has explained, tying arrangements present antitrust concerns, in part, because the seller's exercise of its market power over the tying product may distort customers' purchasing decisions in the market for the tied product. See *Jefferson Parish*, 466 U.S. at 12 (noting that tying arrangements "force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms"); see also *id.* at 13 n.19 (tying doctrine guards against "'distort[ing] freedom of trade and competition in the second product,'" which occurs when consumers "are artificially forced to make a less than optimal choice") (quoting *Fortner Enterprises*, 394 U.S. at 512 (White, J., dissenting)). Similarly, the regulatory circumvention scheme charged here may have distorted petitioners' purchasing decisions; indeed, Discon alleged (Complaint ¶ 34) that it submitted the lowest bid on several occasions, yet was not selected. Any such distortion of competition would ultimately have injured consumers because, under the state regulatory scheme, petitioners could pass on to consumers any increased costs resulting from the distortion. Cf. *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17, 22-23, 25 (1st Cir. 1990) (explaining that antitrust doctrine properly takes into account the applicable regulatory context), cert. denied, 499 U.S. 931 (1991).

In short, contrary to petitioners' characterization, this case involves more than an agreement "to buy

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higher costs, and ratepayers would suffer a $100 loss from petitioners' choice of an inefficient supplier, in addition to any loss attributable to the regulatory evasion.

from Supplier A rather than Supplier B" (Pet. i). An agreement between a regulated monopolist and its supplier to exclude a competing supplier from the market, when that agreement has the purpose and effect of enabling the monopolist to evade regulatory scrutiny and exercise market power in a downstream market, violates Section 1 in the absence of any procompetitive justification. We do not suggest that there will be many cases in which such a claim can be substantiated. Nor do we rule out the possibility of summary judgment in favor of petitioners here. The court of appeals, however, was correct to reverse the dismissal on the pleadings and remand the case for further proceedings.

2. Petitioners contend (Pet. 12) that this case warrants review at this preliminary stage because the court of appeals' opinion creates a "two-firm supplier-purchaser group boycott rule [that] threatens to swallow up the rule that purchasers may choose their suppliers." Although the court misused the "group boycott" label in describing the claim, we do not believe that its opinion threatens the mischief that petitioners suggest. And because "[t]his Court reviews judgments, not statements in opinions," *California* v. *Rooney*, 483 U.S. 307, 311 (1987) (per curiam) (internal quotation marks omitted), the court's incorrect description of the claim does not justify review.

a. The court of appeals characterized the charged conspiracy as a "two-firm vertical" agreement "to discriminate in favor of one supplier over another." Pet. App. 12a. Although the court's opinion is not completely clear, it suggests a three-step analysis for such schemes: (1) the scheme will be denominated a "group boycott" if it is alleged to have anticompetitive effects and no procompetitive justification; (2) such a

scheme might be unlawful *per se* if the defendant fails to advance a valid procompetitive justification; and (3) if a procompetitive justification is substantiated, the scheme should be evaluated under the rule of reason.[10]

This Court, however, consistently has used the term "group boycott" to describe a category of conduct that is illegal *per se*; that is, conduct properly labeled a "group boycott" is condemned without any further inquiry into its anticompetitive effects or procompetitive justification. See, *e.g.*, *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212-213 (1959); see also *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458 (1986); *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958). Application of the *per se* rule serves the salutary purpose of "provid[ing] guidance to the business community" and "minimiz[ing] the burdens on litigants and the judicial system of the more complex rule-of-reason trials." *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 50 n.16 (1977).

Because the *per se* rule applicable to group boycotts permits no defense, this Court has mandated the exercise of "[s]ome care" in defining "[e]xactly what types of activity fall within the forbidden category." *Northwest Wholesale Stationers, Inc.* v. *Pacific Sta-*

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[10] Although it is possible to read the decision, as petitioners do (Pet. 12), to sweep into the group boycott category any two-firm vertical agreement not to use a particular supplier that allegedly lacks a procompetitive purpose, the court of appeals appeared to distinguish a group boycott from other vertical arrangements based on its particular anticompetitive effects. Pet. App. 11a-12a. That is precisely how the same court, in an opinion authored by a judge who joined in the decision below, recently interpreted that decision. See *Electronics Communications Corp.*, 129 F.3d at 244-245 (Parker, J.).

tionery & Printing Co., 472 U.S. 284, 294 (1985); *Indiana Fed'n of Dentists*, 476 U.S. at 458 ("the category of restraints classed as group boycotts is not to be expanded indiscriminately"). The category is thus restricted to "form[s] of concerted activity characteristically likely to result in predominantly anticompetitive effects," *Northwest Wholesale Stationers*, 472 U.S. at 295, such as where "firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor," *Indiana Fed'n of Dentists*, 476 U.S. at 458.

Under this Court's cases, the type of restraint at issue here—a two-firm vertical agreement to exclude a supplier—cannot properly be termed a group boycott. As the court of appeals acknowledged (Pet. App. 12a), "[i]n the vast majority of cases, the decision to discriminate in favor of one supplier over another will have a pro-competitive intent and effect." That correct observation precludes categorical condemnation of such agreements.[11]

The court of appeals, however, employed the terms "group boycott" and "*per se*" analysis differently than has this Court. The court used "group boycott" not to refer to a category of restraint that is condemned, *in every case*, because of its inherently anticompetitive character, but to denote a vertical agreement

[11] Virtually any requirements contract could be characterized as a "two-firm vertical" agreement "to discriminate in favor of one supplier over another." Pet. App. 12a. Yet, such agreements are considered to enhance efficiency, and thus are not subject to categorical invalidation. See *Jefferson Parish*, 466 U.S. at 45 (O'Connor, J., concurring); *Tampa Elec. Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 334 (1961); *Standard Oil Co.* v. *United States*, 337 U.S. 293, 306-307 (1949); *U.S. Healthcare, Inc.* v. *Healthsource, Inc.*, 986 F.2d 589, 595 (1st Cir. 1993).

to exclude a supplier when, *in a particular case*, the agreement allegedly has solely anticompetitive effects. And the court stated that the *per se* rule applies to such agreements only after a detailed inquiry into effects and justification—the very sort of inquiry that, as this Court has explained, the *per se* rule is designed to avoid. See *Northwest Wholesale Stationers*, 472 U.S. at 289; *Continental T.V.*, 433 U.S. at 50 n.16.[12]

b. Although the court of appeals' use of the terms "group boycott" and "*per se*" is at odds with this Court's decisions, we do not believe, as petitioners and *amici* assert (Pet. 12-13; CEMA Br. 9-12; N.Y. Bar Br. 5), that the court's opinion threatens to undermine the analysis of vertical non-price restraints articulated in *Continental T.V.* and *Business Electronics Corporation* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988). The court of appeals declined to decide whether a *per se* analysis or a rule of reason analysis should be applied on remand to the scheme at issue here. See Pet. App. 13a n.6. And the court confirmed that the rule of reason continues to apply to most "two-firm vertical combinations." See *id.* at

[12] The court purported to derive its understanding of group boycotts from *Klor's*, although conceding that *Klor's* was not "directly on point." Pet. App. 11a. In fact, *Klor's* turned not on a case-specific assessment of anticompetitive effects and procompetitive justifications, but on a categorical evaluation of the defendants' conduct. See 359 U.S. at 212-213. Indeed, the Court rejected the argument that the defendants' conduct did not implicate the antitrust laws "because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy." *Id.* at 213. Nor did *Klor's* involve solely a vertical agreement. It included horizontal agreements among suppliers not to deal with a customer. *Ibid.*; see also *Sharp*, 485 U.S. at 734 (describing *Klor's*).

12a ("*in general*, two-firm vertical combinations will be scrutinized as exclusive distributorship controversies," which "are generally considered permissible under the rule of reason" (citing *Sharp*, 485 U.S. at 725-731 & n.4)).

The court of appeals did not precisely delineate the analysis that the district court is to conduct on remand. The court did make clear, however, that petitioners' conduct could not be condemned, whether under rule of reason analysis or under its version of *per se* analysis, without an evaluation of its procompetitive justifications. See Pet. App. 12a (recognizing that petitioners would have an opportunity "to present some pro-competitive justification" for their conduct). Nor did the court suggest that Discon would not be required to prove on remand that petitioners' agreement to exclude it from the removal services market actually had anticompetitive effects. It is thus unclear whether the district court's inquiry on remand will differ significantly from traditional rule of reason analysis.

To the contrary, the approach suggested by the court of appeals here is consistent with that suggested by this Court's opinions in *Indiana Federation of Dentists*, *supra*, and *NCAA* v. *Board of Regents*, 468 U.S. 85 (1984). In those cases, the Court indicated that, once the defendants' conduct has been shown to be anticompetitive based on its character or its effects, the conduct will be deemed to be unreasonable without any extensive market analysis, unless the defendants advance an adequate procompetitive justification. See *Indiana Fed'n of Dentists*, 476 U.S. at 459-461; *NCAA*, 468 U.S. at 109-110 & n.42; see also Joel I. Klein, *Review of Horizontal Agreements—Procompetitive Effects*, 7 Trade Reg. Rep. (CCH) ¶ 50,157 at 49,191 (Nov. 7, 1996) (noting that the Department of Justice uses such an approach to analyze certain types of horizontal restraints). Nothing in the court of appeals' opinion precludes the district court from employing such an approach here.

Accordingly, petitioner and *amici* err in asserting (Pet. 9-10; CEMA Br. 7-8; NY Bar Br. 5) that review is justified because the decision below conflicts with decisions of this Court and other courts of appeals. To be sure, the court of appeals' use of certain terminology differs from that of this Court and, arguably, of those courts of appeals that have required an agreement between competitors in order to invoke the "group boycott" label, see Pet. 9-10 & n.4 (collecting cases); CEMA Br. 7-8 & n.4 (same); see also *U.S. Healthcare, Inc.* v. *Healthsource, Inc.*, 986 F.2d 589, 594 (1st Cir. 1993).[13] The substance of the analysis that the court below suggested, however, does not conflict with this Court's precedents or those of other circuits.

3. The court of appeals' reinstatement of Discon's Section 2 claim likewise does not merit this Court's review. The court correctly held (Pet. App. 14a-15a) that a firm may be liable for conspiring to monopolize when it acts with the specific intent to secure for another firm, although not itself, monopoly power in the target market. See *Perington Wholesale, Inc.* v.

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[13] We say "arguably" because none of those decisions considered the type of conspiracy alleged in this case. Sherman Act "cases must be read in the light of their facts and of a clear recognition of the essential differences in the facts of those cases, and in the facts of any new case to which the rule of earlier decisions is to be applied." *Maple Flooring Mfrs. Ass'n* v. *United States*, 268 U.S. 563, 579 (1925).

Burger King Corp., 631 F.2d 1369, 1377 (10th Cir. 1979).

Petitioners contend (Pet. 14-15; Reply 3) that this holding conflicts with decisions of several courts of appeals finding permissible a buyer's selection of a particular supplier. The court of appeals, however, did not read the complaint to allege merely that petitioners' use of AT&T instead of Discon conferred a large market share on AT&T; rather, the court appeared to find allegations that petitioners intended to assist AT&T in securing monopoly power in the removal services market for the specific purpose of furthering the regulatory evasion scheme. None of the cases that petitioners cite (Pet. 15 & n.8) precludes finding a conspiracy to monopolize in such circumstances.[14] Although there is room to disagree with the court of appeals' reading of the complaint, that case-specific issue does not warrant review by this Court.

4. In any event, this case is not an appropriate vehicle, in its present posture, to clarify the law with respect to conspiracies to exclude competitors in order to evade regulation. The court of appeals de-

[14] Compare *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532, 540 (7th Cir. 1986) (supplier alleged merely to have acquired a large market share); *Dunn & Mavis, Inc.* v. *Nu-Car Driveaway, Inc.*, 691 F.2d 241, 244 (6th Cir. 1982) (no allegations of intent to create monopoly power in new supplier); *Walker* v. *U-Haul Co. of Miss.*, 747 F.2d 1011, 1015 (5th Cir. 1984) (same); *Seagood Trading Corp.* v. *Jerrico, Inc.*, 924 F.2d 1555, 1575 (11th Cir. 1991) (no proof that defendant joined alleged conspiracy); *White* v. *Rockingham Radiologists, Ltd.*, 820 F.2d 98, 104-105 (4th Cir. 1987) (no proof that hospital board, the only entity that could possess monopoly power, joined conspiracy).

cided the issue based only on Discon's "poorly drafted complaint" (Pet. App. 7a), before the parties had any opportunity to develop the facts bearing on either the Section 1 or the Section 2 claims.

Moreover, because the court of appeals reinstated the Section 1 claim on "a different legal theory than the one articulated by Discon" (Pet. App. 7a), petitioners did not raise below all of their arguments against such a theory, and the court thus did not address those arguments. For example, petitioners did not argue in the court of appeals, as they do now (Reply 4), that such schemes fail to cause the type of competitive harm that Section 1 condemns.[15] If the Court were to grant the petition to consider the application of Section 1 to exclusionary agreements in furtherance of regulatory evasion schemes, it would confront the question without the benefit of a developed factual record or lower court opinions, in this case or any other of which we are aware, squarely addressing petitioners' arguments. In our view, therefore, review at this stage would be premature.

Finally, as recognized by the court of appeals (Pet. App. 12a), the antitrust claim advanced in this case is unusual. We are therefore not persuaded that the court of appeals' decision is one of general significance. Indeed, courts may well restrict the decision below (as the Second Circuit itself appears to have done, see *Electronics Communications Corp.*, 129 F.3d at 244-245) to its particular factual context; *i.e.*, to cases in which a regulatory circumvention scheme or similar unconventional vertical arrangement has

[15] See NYNEX C.A. Br. 19-20 (Dec. 11, 1995) (addressing Discon's rule of reason argument).

"manifestly anticompetitive" effects and, assertedly, no procompetitive justification.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
JOEL I. KLEIN
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
A. DOUGLAS MELAMED
Deputy Assistant Attorney General
BARBARA MC DOWELL
Assistant to the Solicitor General
DEBRA A. VALENTINE
General Counsel
Federal Trade Commission
CATHERINE G. O'SULLIVAN
MARK S. POPOFSKY
Attorneys

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No. 96-1570

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISE COMPANY, and NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON INCORPORATED,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF THE CONSUMER ELECTRONICS MANUFACTURERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

JEFFREY L. KESSLER
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, New York 10153
(212) 310-8000

GARY KLEIN
CONSUMER ELECTRONICS MANUFACTURERS ASSOCIATION
2500 Wilson Boulevard
Arlington, Virginia 22201
(703) 907-7677
Counsel for Amicus Curiae

Dated: May 5, 1997

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

Amicus curiae, the Consumer Electronics Manufacturers Association ("CEMA"), pursuant to Supreme Court Rule 37, respectfully moves for leave to file a brief in support of the Petitioners in this matter. Petitioners have provided written consent to CEMA's participation as *amici curiae*. Respondent's have not. *See* Exhibit A.

INTEREST OF AMICUS

The Consumer Electronics Manufacturers Association is a not-for-profit trade association that represents over 300 manufacturers of audio, video and home information equipment. Approximately $66 billion of consumer elec-

tronics products were sold at retail in the United States last year. The decision by the Second Circuit below is of great concern to the members of CEMA because it ignores the settled law of this Court and casts a destructive cloud of antitrust uncertainty upon the highly efficient and pro-competitive business models which individual CEMA members have used to distribute their products to consumers in the United States.

With hundreds of brands being sold of various consumer electronics products, such as televisions, CD players, loudspeakers, computers, and videocassette recorders, the consumer electronics industry has been among the most competitive in the United States. One important aspect of this competition has been the ability of individual manufacturers to select the distributors and retailers with whom they deal in order to maximize and pass along efficiencies, prevent "free riding", and enhance inter-brand competition. The decision below threatens the continuation of these pro-competitive distribution arrangements, which benefit consumers, by raising the possibility that they might be characterized as *per se* unlawful "two-firm group boycotts" subject to treble damage liability.

Because this Court's determination as to whether to grant the Petition will have a critical impact on the ability of consumer electronics companies to continue their pro-competitive business models without facing crippling antitrust risks, it is of substantial interest to *amicus curiae*. Moreover, *amicus curiae* can provide the Court with relevant information about the consumer electronics industry that will assist the Court in assessing the impact of the decision below on pro-competitive distribution arrangements currently being used in the United States.*

* CEMA has previously appeared as *amicus curiae* before this Court in connection with similar antitrust issues having important ramifications for the consumer electronics industry. *See, e.g.* Brief of the Consumer Electronics Manufacturers Association As Amicus Curiae In Support of Affirmance, *Business Elec. Corp.* v. *Sharp Elec. Corp.*, No. 85-1910 (filed Nov. 6, 1987).

CONCLUSION

For the foregoing reasons, CEMA respectfully submits that it has the necessary interest in this matter to participate as *amicus curiae*, and that its filing of a brief will be desirable and useful for the Court. A copy of this brief is submitted with this motion.

Respectfully submitted,

JEFFREY L. KESSLER
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, New York 10153
(212) 310-8000

GARY KLEIN
CONSUMER ELECTRONICS
MANUFACTURERS ASSOCIATION
2500 Wilson Boulevard
Arlington, Virginia 22201
(703) 907-7677
Counsel for Amicus Curiae

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1570

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISE COMPANY, and NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON INCORPORATED,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF THE CONSUMER ELECTRONICS MANUFACTURERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

The Consumer Electronics Manufacturers Association ("CEMA"), a not-for-profit trade association that represents over 300 manufacturers of audio, video and home information equipment, files this *amicus curiae* brief in support of Petitioners.[1] Approximately $66 billion of consumer electronics products were sold at retail in the United States last year. The decision by the Second Circuit below

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[1] Pursuant to Rule 37.2(a) of this Court, consent to the filing of this brief has been granted by Petitioners but denied by Respondents. Petitioners' consent has been filed with the Clerk of the Court.

is of great concern to the members of CEMA because it ignores the settled law of this Court and casts a destructive cloud of antitrust uncertainty upon the highly efficient and pro-competitive business models which individual CEMA members have used to distribute their products to consumers in the United States.

With hundreds of brands being sold of various consumer electronics products, such as televisions, CD players, loudspeakers, computers, and videocassette recorders, the consumer electronics industry has been among the most competitive in the United States. One important aspect of this competition has been the ability of individual manufacturers to select the distributors and retailers with whom they deal in order to maximize and pass along efficiencies, prevent "free riding", and enhance interbrand competition.[2] The decision below threatens the continuation of these pro-competitive distribution arrangements, which benefit consumers, by raising the possibility that they might be characterized as *per se* unlawful "two-firm group boycotts" subject to treble damage liability. Because this Court's determination as to whether to grant the Petition will have a critical impact on the ability of consumer electronics companies and other manufacturers to continue their pro-competitive business models without facing crippling antitrust risks, it is of substantial interest to *amicus curiae*.[3]

SUMMARY OF ARGUMENT

By resurrecting the possibility of applying a *per se* rule of illegality to vertical non-price distribution agreements,

[2] The terms "distributor(s)" and "retailer(s)" are used interchangeably throughout this brief, as some consumer electronic manufacturers use a two-step distribution process—going through distributors to retail dealers—while others sell directly to retail dealers.

[3] This *amicus curiae* brief represents the consensus view of the diverse membership of CEMA. It should not be construed as having been submitted on behalf of or representing the views of any individual company.

the decision below is in direct conflict with prior decisions of this Court and the decisions of other Circuit Courts of Appeals. Moreover, by significantly increasing the uncertainty of treble damage liability in the previously settled law of vertical restraints, the Court of Appeals' decision places in jeopardy, and will significantly increase the costs of, efficient distribution arrangements and pro-competitive business models which would otherwise pass through to consumers the benefits of competition in the form of lower prices, greater services and enhanced product availability.

Twenty years ago, this Court revolutionized antitrust law by recognizing the pro-competitive benefits of vertical non-price restraints and holding them subject to the rule of reason, as opposed to the *per se* rule. *Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 57-59 (1977). Twelve years ago, this Court made it clear that the *per se* rule against even horizontal group boycotts should not apply where there was a reasonable possibility of an efficiency justification. *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 293-298 (1985). Nine years ago, this Court completed the circle by holding that, in the absence of an agreement to fix specific prices or price levels, the rule of reason applied to all vertical agreements, even when they had horizontal effects on price competition. *Business Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717, 735 (1988). The combined effect of these decisions has been to permit the full realization of efficiency-enhancing vertical supply and distribution arrangements, which have greatly benefited consumers. The decision below threatens these benefits, and directly conflicts with the fundamental teachings of *GTE Sylvania*, *Northwest Stationers* and *Sharp*, by resurrecting the possibility that the *per se* rule against group boycotts may be applied to vertical agreements by a single manufacturer to do business with only particular suppliers or distributors.

The consumer electronics industry has been a leader in developing pro-competitive business models for vertical

distribution structures that have provided enormous benefits to consumers. Indeed, these models have made the distribution of consumer electronics products in the United States the most efficient and competitive in the world. The decision below threatens these pro-competitive distribution arrangements by exposing the manufacturers who develop such arrangements to the uncertainty and threat of *per se* treble damage liability.

As this Court has recognized, for many products, competition is most effective when retailers offer prospective purchasers a high level of pre-sale and post-sale services, educating the customer about the product, demonstrating its capabilities, and exploring with the customer whether the product meets his or her needs. These services are particularly important for products which are new to the market and unfamiliar to consumers, and, in general, for any complex product where consumer demand depends on understanding the product and receiving a high level of pre and post-sale service. The provision of such services maximizes inter-brand competition, increases sales, and enhances consumer satisfaction.

A manufacturer which has researched a market, identified a demand, and developed a product to meet that demand thus has a critical interest in structuring the distribution network through which its product will be sold. To ensure the efficient marketing of its products, a manufacturer must be able to exercise a reasonable degree of control over its distribution network, including the ability to select with whom it will deal. In particular, to create a distribution system in which dealers offer the most effective mix of services, a manufacturer must be able to limit the number of its dealers and enter into such other vertical non-price agreements as may be necessary to realize efficiencies and/or enhance inter-brand competition.

This Court should grant the Petition to prevent the decision below from chilling a manufacturer's ability to

create and maintain efficient distribution and supply networks by permitting artful antitrust pleading against such distribution arrangements to raise a new and unwarranted threat of *per se* treble damage liability. Hundreds of billions of dollars of commerce could be adversely affected if the decision below is permitted to inject new antitrust risks and uncertainty into the previously settled law of vertical non-price restraints.

ARGUMENT

I. THE DECISION BELOW IS IN CONFLICT WITH THE PRIOR RULINGS OF THIS COURT AND CREATES A SPLIT OF AUTHORITY AMONGST THE CIRCUIT COURTS OF APPEALS.

Beginning with the landmark decision in *GTE Sylvania* and extending through the more recent ruling in *Sharp*, this Court has revolutionized antitrust law in the area of vertical non-price restraints by holding that the substantial potential of these arrangements to provide pro-competitive benefits requires application of the fiexible rule of reason, rather than any *per se* rule. *See, e.g., Sharp Elec. Corp.*, 485 U.S. 717 (1988); *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984); *GTE Sylvania, Inc.*, 433 U.S. 36 (1977). The results have been of enormous benefit to consumers and manufacturers alike—with the United States developing the most efficient and competitive distribution networks in the world.

Despite the above, the Second Circuit has now injected new uncertainty and risks of treble damage liability into the previously settled law of vertical non-price restraints by holding that a *per se* rule of illegality might be applied to certain vertical distribution or supply agreements if they can be characterized as a "two-firm group boycott." Petition ("Pet.") at 11a-13a. This ruling conflicts with the prior decisions of this Court, and other circuits, in at least three important respects.

First, the decision below conflicts with the basic rule of *GTE Sylvania* and *Sharp* that vertical non-price restraints should always be judged under the rule of reason because of their potential for pro-competitive, efficiency-enhancing benefits:

> In [*GTE Sylvania*] we refused to extend per se illegality to vertical nonprice restraints specifically to a manufacturer's termination of one dealer pursuant to an exclusive territory agreement with another. . . . We concluded that vertical nonprice restraints had not been shown to have such a "pernicious effect on competition" and to be so "lacking in redeeming value" as to justify per se illegality. Rather, we found that they had real potential to stimulate interbrand competition, "the primary concern of antitrust law."

Sharp, 485 U.S. at 724 (citing to *GTE Sylvania, supra* at 58-59). Moreover, as these decisions point out, a *per se* rule is unwarranted because there is no economic support for the claim that non-price vertical restraints have any cartel-facilitating effect:

> [The] opinion in *GTE Sylvania* noted a significant distinction between vertical nonprice and vertical price restraints. That is, there was support for the proposition that vertical price restraints reduce interbrand price competition because they facilitate cartelizing. . . . Similar support for the cartel-facilitating effect of vertical nonprice restraints was and remains lacking.

Sharp, supra, 485 U.S. at 725 (citations and internal quotations omitted).

There is thus no basis for the Second Circuit's holding that a *per se rule* of illegality could be applicable to an agreement by a manufacturer to use only one supplier or distributor merely because the face of the complaint alleges an anti-competitive intent and effect and does not

disclose any procompetitive rationale. *Petition* at 12a. If not reversed, disgruntled dealers and suppliers around the country can be expected to make similar allegations in order to threaten manufacturers who do not wish to deal with them with the possibility of *per se* treble damage liability.

Second, the decision below disregarded the controlling authority of *Sharp* when it relied upon pre-*Sharp* precedent for the proposition that "an agreement between two firms . . ., even in a vertical relationship, may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor . . . of one of the conspiring firms." *Pet.* at 10a-11a (citations omitted). This "horizontal effects" rationale for applying a *per se* rule to a vertical non-price agreement was expressly advocated by the dissent, but rejected by the majority opinion, in *Sharp*:

> The dissent apparently believes that whether a restraint is horizontal depends upon whether its anticompetitive effects are horizontal, and not upon whether it is the product of a horizontal agreement. That is of course a conceivable way of talking, but if it were the language of antitrust analysis there would be no such thing as an unlawful vertical restraint, since all anticompetitive effects are by definition horizontal effects.

485 U.S. 717, 730. By adopting the rejected views of the *Sharp* dissent, the decision below is in direct conflict with the holdings of this Court.

Third, the decision below conflicts with this Court's prior decisions as well as the decisions of nine other Courts of Appeal, in holding that the *per se* rule of *Klor's Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), can be applied to so-called "two-firm group boycotts." As the Second Circuit first noted, but then disregarded, *Klors* involved a situation in which several

competing manufacturers conspired with a retailer not to deal with a particular customer (*i.e.*, it was a *horizontal agreement*). *Pet.* at 11a. It did not concern a purely vertical agreement with one supplier or distributor not to deal with others, such as was at issue below. Extending the *per se* rule against group boycotts to such vertical non-price agreements is contrary to this Court's decision in *Northwest Wholesale Stationers*, which made it clear that the *per se rule* against group boycotts should be limited to only those horizontal boycotts by firms with market power that lack any plausible efficiency justification. *Northwest Wholesale Stationers*, 472 U.S. at 293-98. It is also contrary to this Court's decision in *Sharp*, which applied the rule of reason, not the *per se* rule, to an alleged agreement with one customer to terminate another. *Sharp*, 485 U.S. at 735. Finally, it is contrary to the decision of at least nine other circuits, which have refused to extend the *per se* rule of *Klors* to purely vertical agreements in the guise of "two-firm group boycotts."[4]

In sum, the Second Circuit's decision is in direct conflict with the decision of this Court as well as other Courts of Appeal. Unless the Petition is granted to correct this fundamental error, the settled antitrust environ-

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[4] *See, e.g., Bailey's Inc.* v. *Windsor America, Inc.*, 948 F.2d 1018, 1031 (6th Cir. 1991); *Lomar Wholesale Grocery, Inc.* v. *Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 590-91 (8th Cir. 1987); *Westman Commission Co.* v. *Hobart Int'l, Inc.*, 796 F.2d 1216, 1224 n.1 (10th Cir. 1986), *cert. denied*, 486 U.S. 1005 (1988); *Terry's Floor Fashions, Inc.* v. *Burlington Indus., Inc.*, 763 F.2d 604, 610 n.10 (4th Cir. 1985); *Construction Aggregate Transp., Inc.* v. *Florida Rock Indus., Inc.*, 710 F.2d 752, 775 n.42 (11th Cir. 1983); *Products Liab. Ins. Agency, Inc.* v. *Crum & Forster Ins. Cos.*, 682 F.2d 660, 664-65 (7th Cir. 1982); *Gough* v. *Rossmoor Corp.*, 585 F.2d 381, 387 (9th Cir. 1978); *E.A. McQuade Tours, Inc.* v. *Consolidated Air Tour Manual Comm.*, 467 F.2d 178, 186 (5th Cir. 1972), *cert. denied*, 409 U.S. 1109 (1973); *Ark Dental Supply Co.* v. *Cavitron Corp.*, 461 F.2d 1093, 1094 (3d Cir. 1972).

ment in which pro-competitive vertical distribution and supply decisions have been made will be severely undermined.

II. THE PETITION SHOULD BE GRANTED TO PREVENT THE SECOND CIRCUIT'S DECISION FROM HAVING SERIOUS ADVERSE CONSEQUENCES FOR CONSUMERS AND BUSINESSES.

If not overturned, the Court of Appeals' decision will have serious adverse effects on consumers and businesses throughout the country. It will significantly raise the risk of treble damage liability and inject new uncertainty into the law of vertical non-profit restraints—chilling the many efficient distribution arrangements which the members of CEMA and other manufacturers have carefully developed over the last two decades to bring to consumers the benefits of competition. Indeed, because manufacturers who distribute their products on a nationwide basis can generally be subject to suit in many parts of the country, a departure from this Court's law of vertical restraints in just a single Circuit Court of Appeals can significantly threaten a company's pro-competitive distribution agreements.

The consumer electronics industry in which the members of CEMA participate presents a classic example of the type of efficient distribution arrangements that will be placed in jeopardy if the decision below is not reversed. Over the past ten years, there have been few industries more competitive than the consumer electronics industry. This is evident from not only the rapid pace of technical innovation and new product introduction in these businesses, but also from the remarkable achievement of price deflation of three percent or more annually, across the entire marketplace of consumer electronics goods:

Goods	1986 Average Dealer Price (Dollars)	1996 Average Dealer Price (Dollars)	Total / Annual Percent Change
CD Player	207	157	−24 / −3
Stereo Tape Deck	159	114	−28 / −3
Home Speakers	98	66	−33 / −4
Boombox	40	30	−25 / −3
Car CD Player	489	199	−59 / −9
VCR	296	200	−32 / −4
Camcorder	1,029	565	−45 / −6
25" Color TV	404	255	−37 / −4

These benefits of vigorous competition have been passed onto consumers through the efficient distribution arrangements which members of CEMA have been able to enter into under the flexible rule of reason that is applied to vertical non-price restraints. The Court of Appeal's decision deals a serious blow to these pro-competitive business models by creating the risk and uncertainty that a *per se* rule of illegality might be applied to purely vertical agreements by a manufacturer to do business with only a limited number of suppliers or dealers.

Most manufacturers of consumer electronics products rely on specific types of retailers to bring their products to consumers. The specific type of distribution arrangement that will maximize efficiencies varies from product to product. A manufacturer who has studied a market, identified a demand, and developed a product to satisfy that particular demand, is in the best position to know what sort of vertical distribution arrangements will maximize the competitiveness of its products in the marketplace. To carry out these pro-competitive decisions, an ability to enter into vertical agreements without the draconian risk of possible *per se* antitrust liability is essential.

For many consumer electronics products, effective marketing requires that retailers provide consumers with a high level of pre- and post-sale services. A manufacturer that has developed a new type of product may require retailers to provide potential customers with information

about the product's function and capabilities, in order to educate consumers. Or, a manufacturer that believes its product has significant advantages over the products of its competitors may require the retailer to incur the expense necessary to train a staff which can explain and demonstrate those advantages. A manufacturer may also wish to ensure that retailers carry a broad line of products, maintain sufficient stock to be able to meet orders quickly, provide an attractive and spacious shopping environment, offer prompt delivery and installation, or maintain facilities to repair products the retailer has sold. As this Court recognized in *GTE Sylvania*:

> The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product. Because of market imperfections such as the so-called "free-rider" effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did.

GTE Sylvania, 433 U.S. at 55.

One example of an entire product category where consumers have benefitted from exclusive distribution relationships is "high-end" audio products. These are higher priced, high quality loudspeakers, amplifiers and stereo components manufactured by over 100 U.S. companies and recognized worldwide as being superior to mass-market audio products. Most high-end companies, such as Martin-Logan, Thiel, Conrad-Johnson and Meridian, rely on only one dealer per marketplace. They invest in and train this dealer to provide the pre- and post-sale services which consumers require. This U.S. distribution model is played out worldwide where high-end audio companies maintain exclusive distribution arrangements with international distributors in other countries. It is this type of procompetitive vertical distribution model, which has allowed the U.S. high-end audio industry to

prosper and produce some one billion in U.S. exports, that is being threatened with the possibility of *per se* antitrust liability by the decision below.

In order to maintain such pro-competitive distribution arrangements, it is critical that manufacturers, like the members of CEMA, retain the freedom to enter into vertical non-price agreements, and limit those dealers with whom they will do business, without facing rampant antitrust uncertainty and the risk of *per se* treble damage liability. The decision below destroys the reasonable and certain antitrust environment which this Court has fostered to make possible the development and maintenance of pro-competitive vertical non-price restraints. Certiorari should be granted to reverse this fundamental error, which endangers pro-competitive distribution arrangements in the consumer electronics and other industries.

CONCLUSION

For the reasons set forth above, *amicus curiae* respectfully urges that a writ of certiorari should issue to review the judgment of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

JEFFREY L. KESSLER
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, New York 10153
(212) 310-8000

GARY KLEIN
CONSUMER ELECTRONICS
MANUFACTURERS ASSOCIATION
2500 Wilson Boulevard
Arlington, Virginia 22201
(703) 907-7677
Counsel for Amicus Curiae

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IN THE

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OCTOBER TERM, 1997

NYNEX CORPORATION;
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NEW YORK TELEPHONE COMPANY,

Petitioners,

— v. —

DISCON, INCORPORATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF AMICUS CURIAE IN SUPPORT OF THE PETITIONERS

RICHARD M. STEUER
425 Park Avenue, 12th Fl.
New York, New York 10022
(212) 836-8483

Attorney for Amicus Curiae
The Association of the Bar of
the City of New York

April 9, 1997

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Pursuant to Rule 37 of the Rules of this Court, this brief is respectfully submitted, in support of the Petition, by *amicus curiae,* the Association of the Bar of the City of New York. The consent of the parties to the filing of this brief has been requested. Petitioners have given consent; respondent has not.

INTEREST OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

The Association of the Bar of the City of New York (the "Association") is an organization composed of nearly 21,000 attorneys. While most members of the Association practice in the New York tri-state area, there are members from almost every state and from over 50 foreign countries. The Committee on Antitrust and Trade Regulation, which has participated in studying and shaping antitrust law and trade regulation policy for several decades, is comprised of lawyers with a wide range of perspectives. Members of the Committee include practitioners who represent both plaintiffs and defendants, as well as academicians.

The Second Circuit's August 26, 1996 decision in this matter was brought to the attention of the Association by one of the parties. The Association is concerned that this decision could cause serious confusion with respect to the distinction between horizontal and vertical restraints of trade under Section 1 of the Sherman Act, 15 U.S.C. §1.

Accordingly, the Association respectfully moves for leave to file the "Brief Amicus Curiae of the Association of the Bar of the City of New York in Support of the Petitioners" which is submitted herewith. The filing of this brief has been

approved by the President of the Association in accordance with Section XIII of the Association's by-laws.

Respectfully submitted,

/s/ Richard M. Steuer

RICHARD M. STEUER
425 Park Avenue, 12th Fl.
New York, New York 10022
(212) 836-8483

Attorney for Amicus Curiae
The Association of the Bar of
the City of New York

April 9, 1997

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INTEREST OF *AMICUS CURIAE*

The Association of the Bar of the City of New York (the "Association") is an organization composed of nearly 21,000 attorneys. While most members of the Association practice in the New York tri-state area, there are members from almost every state and from over 50 foreign countries. The Committee on Antitrust and Trade Regulation, which has participated in studying and shaping antitrust law and trade regulation policy for several decades, is comprised of lawyers with a wide range of perspectives. Members of the Committee include practitioners who represent both plaintiffs and defendants, as well as academicians. The Committee, the Association and their members have a substantial interest in the Court's determination as to when a vertical agreement may be treated as a horizontal restraint under the Sherman Act.

SUMMARY OF ARGUMENT

Unless the Petition is granted in this case, the decision of the court of appeals for the Second Circuit with respect to the application of Section 1 of the Sherman Act will have the effect of allowing every supplier who is displaced by an agreement between a customer and a new supplier to seek treble damages based on a violation of the federal antitrust laws. Such suits would level claims of *per se* antitrust liability against lost customers, where the supplier otherwise would be limited to filing state law claims based on tortious interference against the new supplier. Because the *per se* rule presumes illegality, the defendants in these cases would be precluded from presenting evidence of justifications.

Of particular concern is the fact that the Second Circuit based its decision on court of appeals cases that were decided prior to this Court's decision in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988). Although the Second Circuit acknowledged the relevance of *Sharp*, it failed to recognize the fact that *Sharp* overruled the earlier authority under which a defendant's decision to substitute a new supplier or distributor for an old one could be treated as a horizontal restraint. For these reasons we urge this Court to grant the petition for certiorari in order to clarify the law regarding horizontal effects arising from vertical relationships.

ARGUMENT

The Association respectfully submits the following comments in support of the pending petition for a writ of certiorari in this matter.

Without expressing an opinion on either the appropriate resolution of the motion to dismiss that is the subject of the present appeal, or the ultimate outcome of this litigation, the Association urges the Court to grant the petition for a writ of certiorari and to decide the issue of the applicability of Section 1 of the Sherman Act, 15 U.S.C. § 1, to what the Court of Appeals for the Second Circuit termed "two-firm group boycotts." Slip. Op. at 7236. The Association's concern is that the Second Circuit's broad formulation as to when a vertical agreement may be treated as a horizontal restraint, crafted *sua sponte* without the benefit of briefing or argument by the parties, and without a full explanation of how it fits within applicable Supreme Court precedent, will have a powerful influence beyond this particular case.

The Second Circuit's decision with respect to the application of Section 1 of the Sherman Act turns on the proposition that an agreement between two firms in a vertical relationship may be characterized as a horizontal restraint if it seeks to disadvantage a competitor of one of the parties to the agreement and has no purpose except stifling competition. Specifically, the Second Circuit observed that "an agreement between two firms . . . even in a vertical relationship, may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor . . . of one of the conspiring firms," and the court added that such a restraint might fall within "the *per se* rule applied to group boycotts

. . . if the restraint of trade 'has no purpose except stifling competition.'"[1]

The concern raised by this formulation is that it could be interpreted to reach virtually every agreement between a customer and a supplier that displaces another supplier. This would invite a flood of federal antitrust litigation seeking treble damages on behalf of jilted suppliers. These suits would assert claims of *per se* antitrust liability against lost customers in situations where, at most, the disappointed supplier otherwise would be limited to pursuing a state law claim against the substituted supplier for tortious interference with business relationships and/or unfair competition. Because the *per se* rule presumes illegality, defendants in these suits would be precluded from presenting evidence of justifications.

What makes the Second Circuit's ruling particularly significant is the fact that it is based on *Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126 (2d Cir.) (*en banc*), *cert. denied*, 439 U.S. 945 (1978), and other cases which were decided before this Court's decision in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 725-31 & n.4 (1988). Although the Second Circuit's opinion acknowledged the relevance of *Sharp*, it did not recognize that *Sharp* overruled the earlier authority under which a defendant's decision to substitute a new supplier or distributor could be treated as a horizontal restraint. This Court explained in *Sharp* that "a restraint is horizontal not because it has horizontal effects, but

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[1] Slip. op. at 7237, *citing* Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, at 131 (2d Cir.) (*en banc*), *cert. denied*, 439 U.S. 945 (1978), *quoting* White Motor Co. v. United States, 372 U.S. 253, 263 (1963).

because it is the product of a horizontal agreement" (*i.e.*, an agreement "between competitors"). 485 U.S. at 730, and n.4. Further, the majority in *Sharp* explicitly admonished that applying the horizontal label to vertical agreements "introduces needless confusion into antitrust terminology." *Id.* at 730.

The opinion below should be reexamined precisely because it introduces needless confusion by treating a vertical restraint as horizontal on the ground that it has horizontal effects.

CONCLUSION

Wherefore, the Association respectfully submits that the petition for writ of certiorari should be granted.[2]

Respectfully submitted,

RICHARD M. STEUER
425 Park Avenue, 12th Fl.
New York, New York 10022
(212) 836-8483

Chair, Committee on Antitrust
and Trade Regulation
Attorney for Amicus Curiae
The Association of the Bar
of the City of New York

April 9, 1997

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[2] Granting the petition for writ of certiorari would also afford this Court the opportunity to review the Second Circuit's holding that a conspiracy to monopolize claim against a customer under Section 2 of the Sherman Act, 15 U.S.C. § 2, can be based on a vertical agreement between the customer and a new supplier which displaces a previous supplier.

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No. 96-1570

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES COMPANY,
and NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON, INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY BRIEF FOR PETITIONERS

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
1850 M Street, NW
Washington, DC 20036
(202) 775-0184

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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NYNEX CORPORATION,
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Petitioners,

v.

DISCON, INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONERS

I. THE SECOND CIRCUIT'S SECTION 1 HOLDING SHOULD BE REVERSED

Discon seeks to preserve its Section 1 claim in two ways. First, it argues that the question presented is limited to *per se* liability, thus foreclosing consideration of, and preserving for further litigation on remand, the question of rule-of-reason liability. Second, on the merits, while Discon now disclaims any anticompetitive effect in the telephone-service market, Discon tries to explain why it has sufficiently alleged anticompetitive effects in the sale of removal services.

Neither argument has merit. The Second Circuit's sole basis for reviving the Section 1 claim (extending "group boycott" doctrine, whether triggering *per se* or rule-of-reason analysis) and its sole rationale (its finding of anticompetitive effects, whether in telephone-service or removal-services markets) are squarely before this Court. And, with any claim of harm to competition in the telephone-service market properly out of the case, Discon's arguments about the sale of removal services starkly confirm that its allegations state no more than harm to itself as a competitor, rather than any marketwide harm to competition.

A. The Petition Encompasses The Entire Basis For The Second Circuit's Revival Of The Section 1 Claim And Its Rationale That There Are Sufficiently Alleged Anticompetitive Effects

Seeking to avoid this Court's consideration of whether the amended complaint adequately alleges anticompetitive effects, Discon argues that the first question presented does not fairly include the issue of rule-of-reason liability. *See* Discon Br. 20. Surprisingly, the Government makes this argument as well (SG Br. 17-19), even though at the petition stage the Government gave no hint that any of its extensive discussion of anticompetitive effects and rule-of-reason liability was addressing issues not properly before the Court (SG Pet. Br. 6-17). This argument is doubly mistaken. First, its premise that rule-of-reason liability is outside the scope of the petition is wrong. Second, the conclusion would be wrong even if the first question presented were limited to *per se* liability: the Second Circuit's sole rationale, finding anticompetitive effects, would be present regardless.

1. Discon and the Government are flatly incorrect in contending that the first question presented is limited to whether *per se* liability is available. The question does

not even use the language of "*per se*" liability.[1] Rather, it uses the Second Circuit's own language of "group boycott." The Second Circuit articulated one and only one basis for reviving Discon's Section 1 claim: that "group boycott" doctrine, though historically applicable only to agreements involving competitors, should be "extended" to this case, whether that extension ultimately would trigger *per se* or rule-of-reason analysis. Pet. App. 11a-13a & n.6. The evident point of the group-boycott-extension ruling (regardless of whether *per se* or rule-of-reason analysis would follow) was to distinguish this particular two-firm vertical nonprice agreement from the mine-run of purchaser-supplier agreements—which are routinely approved by the courts (NYNEX Br. 23-24 & n.18)—and stamp it with the special heightened suspicion of anticompetitive effects attaching to "group boycotts." The first question in the petition, by its terms, sought review of the "group boycott" ruling, the full basis for the Second Circuit's resurrection of Discon's Section 1 claim.

The argument that the question excludes rule-of-reason liability rests on a simple error: it misunderstands the Second Circuit, and hence the petition, to have used "group boycott" as co-extensive with *"per se."* SG Br. 11-18. The Second Circuit, following its own prior usage (*see* NYNEX Br. 16-17 (citing cases)) and the usage common in other circuits,[2] indisputably used "group boycott" to encompass agreements that might be judged

---

[1] "When a Purchaser agrees to buy from Supplier A rather than Supplier B, and there is no issue of any horizontal restraints or vertical price restraints: 1. May the agreement between Purchaser and Supplier A be characterized as a group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?" Pet. i.

[2] *See, e.g., Levine v. Central Florida Medical Affiliates, Inc.*, 72 F.3d 1538, 1550 (11th Cir.), *cert. denied*, 117 S. Ct. 75 (1996) (not all "group boycotts" are subject to *per se* condemnation); *Bhan v. NME Hosp., Inc.*, 929 F.2d 1404, 1411-12 (9th Cir.), *cert. denied*, 502 U.S. 994 (1991) (same); *Collins v. Associated Pathologists*, 844 F.2d 473, 479-80 (7th Cir.), *cert. denied*, 488 U.S. 852 (1988) (same).

under either *per se* or rule-of-reason standards.[3] The Second Circuit expressly indicated its understanding that at least some "two-firm group boycott[s] should be judged under [the] rule of reason" (Pet. App. 12a, summarizing *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 725-31 & n.4 (1988)), and in its critical statement that either a *per se* or rule-of-reason standard might be available on remand, it expressly referred to "applying the rule of reason to two-firm group boycotts." Pet. App. 13a n.6. Not surprisingly, then, Discon, despite its brief effort to limit this Court's inquiry, has unambiguously acknowledged that the Second Circuit's "group boycott" ruling in fact covered both the *per se* and rule-of-reason standards (Discon Br. 10):

> The Court of Appeals concluded that a vertical agreement between a firm and its supplier to exclude a competing supplier may be treated as a "group boycott", addressable both under the rule of reason and the *per se* rule if the "restraint of trade has no purpose except stifling competition."

The petition, in directly challenging the Second Circuit's extension of "group boycott" doctrine to this case, thus

[3] Contrary to the Government's assertion (SG Br. 13 n.7), this Court in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985), similarly used "group boycott," a synonym for "concerted refusal to deal," to encompass both *per se* and rule-of-reason standards: it expressly approved the district court's statement that "[e]ven if it is a group boycott, . . . the Rule of Reason operates" in that case. *Id.* at 297 n.9; *see* NYNEX Br. 17 n.14. In any event, any dispute about *this Court*'s usage is ultimately irrelevant. The question presented, in challenging the Second Circuit's holding that "group boycott" should be extended, necessarily was referring to what the *Second Circuit* meant by "group boycott," plainly covering both *per se* and rule-of-reason situations. It is bizarre for the Government to criticize (and thus acknowledge) the Second Circuit's usage of "group boycott" as embracing agreements that are *not* necessarily *per se* invalid (SG Br. 15-16; SG Pet. Br. 12-13) and then to turn around and deny that the broader usage is precisely what is adopted in the question presented.

encompasses both the *per se* and the rule-of-reason standards that the Second Circuit concededly invoked under that rubric.[4]

2. Even if the first question were improperly read as limited to *per se* liability, the issue of whether anticompetitive effects have been sufficiently alleged in the telephone-service or removal-services markets would be squarely encompassed within the question. The Second Circuit's one and only affirmatively stated rationale for its Section 1 ruling (extension of group boycott analysis) was its conclusion that the alleged conduct was "entirely anti-competitive." Pet. App. 12a; *see Electronics Communications Corp. v. Toshiba America Consumer Prods.*, 129 F.3d 240, 244-45 (2d Cir. 1997) (*Discon* decision rests on finding that alleged conduct was "manifestly anticompetitive"). In so holding, the Second Circuit did not "clearly identify" (SG Br. 7 n.5) whether it was referring to an anticompetitive effect in the telephone-service market or an anticompetitive effect in an alleged removal-services market. *See also* Discon Br. 8-9 ("[t]he circuit court did not specifically identify any specific market affected . . . [or] a particular anticompetitive effect") (footnotes omitted). Accordingly, NYNEX's opening brief, far from ranging beyond the question presented, squarely addressed the Second Circuit's "entirely anticompetitive" conclusion as applied to each of the two market levels at issue, arguing that the alleged fraudulent overcharging of ratepayers did not constitute an anticompetitive effect in the tele-

[4] That the first question presented challenges the Second Circuit's full Section 1 holding (including rule-of-reason liability) is confirmed by the second question presented, which challenges the court of appeals' Section 2 conspiracy holding. NYNEX's initial ground for arguing that the alleged agreement cannot be an unlawful Section 2 conspiracy is that otherwise—as the Government expressly agrees (SG Br. 20 n.12)—it would then have to be an unlawful Section 1 conspiracy. *See* NYNEX Br. 40; Pet. 14-15; page 17, *infra*. The basis for that argument is the absence of any valid Section 1 liability, *per se* or rule-of-reason.

phone-service market (NYNEX Br. 27-36) and that there was no sufficient allegation of harm to competition in the sale of removal services (*id.* at 36-39). It is unheard-of to view this direct challenge to the rationale for the ruling presented for review as somehow outside the question presented.[5]

B. The Amended Complaint Does Not Sufficiently Allege The Required Harm To Competition

The Second Circuit reinstated Discon's Section 1 claim because it deemed the alleged agreement "entirely anticompetitive." To defend the decision, Discon must show, at the least, that the alleged agreement harmed competition, not just Discon as a competitor. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993). Discon must meet a still higher standard to justify, as it briefly tries to do (Discon Br. 14-19), any *per se* illegality; the agreement would have to be of a type that has such "limited potential for procompetitive benefit" and "such predictable and pernicious anticompetitive effect" (*State Oil Co. v. Khan*, 118 S. Ct. 275, 279 (1997)) that it "would always or almost always" harm competition (*Sharp*, 485 U.S. at 723 (internal quotation marks omitted)). Here, neither standard is met.

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[5] The imprecision in the Second Circuit's opinion led the Government, in its brief at the petition stage, to defend the Second Circuit's ruling principally based on supposed anticompetitive effects in the telephone-service market (SG Pet. Br. 8-12), while Discon now insists that the Second Circuit was referring only to "the removal services market" (Discon Br. 30). As noted below, Discon's new disclaimer of any reliance on anticompetitive effects in the telephone-service market removes the issue from the case, but that disclaimer on the merits hardly means that the issue, as one of the two possible interpretations of the Second Circuit's rationale, was outside the question presented. Similarly, the novelty of the Government's petition-stage reliance on anticompetitive effects in the telephone-service market—a novelty that the Government mistreats as making the issue difficult rather than easy (SG Br. 18-19)—does not exclude the issue from the question presented.

As the Government agrees (SG Br. 11-17), *per se* liability plainly cannot apply: this Court repeatedly has held that nonprice vertical agreements (tying agreements aside) are subject only to a rule-of-reason standard. *See* NYNEX Br. 20-21. Those holdings rest on the recognition (*id.* at 21-24; SG Br. 15) that even an exclusive-dealing agreement, let alone an agreement by a purchaser merely to "favor . . . one supplier over another" (Pet. App. 12a), typically serves legitimate procompetitive objectives, such as stability of supply and reduced transaction costs. The factual allegations here identify, at most, an agreement by NYNEX to buy only from AT&T and not from Discon, *i.e.*, at most an exclusive-dealing agreement. (As for procompetitive justification, Discon has itself unexpectedly pointed to, while denying, a specific legitimate basis for NYNEX's not buying from Discon, namely, Discon's improper dealings with a NYNEX employee. *See* NYNEX Br. 4-5.)

Even if the agreement were alleged to have a purpose to exclude Discon, a particular competitor, from the market, *per se* liability still would be improper. The contrary legal position is urged by one *amicus* brief, which recognizes that the factual allegations in the amended complaint do not actually identify a NYNEX agreement to do any more than cease using Discon as a supplier. Law Professors *Amicus* Br. 4-6.[6] This position is fundamentally inconsistent with this Court's precedents and would broadly "subsume the rule of reason" in supplier- or dealer-substitution cases because of the ease of making an allegation of purpose to exclude. Ass'n of Bar of City of New York

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[6] The *amicus* brief (at 4-5 n.3) discusses two possible exceptions, and then immediately discounts them. One involves allegedly defamatory statements about Discon, but, among other deficiencies, there is no allegation that such statements were, or were intended to be, republished to harm Discon's relationship with other buyers. The other involves NYNEX's alleged compulsion of Discon to injure a scrap-metal buyer, but, among other deficiencies, there is no allegation that the conduct was pursuant to any agreement with AT&T.

Amicus Br. 8-9 n.4. It is also insupportable under basic antitrust principles. An allegation of "purpose" to exclude (Law Professors *Amicus* Br. 11) by its terms addresses only harm to a particular competitor and adds nothing about any harm to marketwide competition, which is antitrust law's concern. *See id.* at 13 (treating such an exclusion agreement as "not directed at competition in the usual antitrust sense"). At the same time, allowing such an allegation to change the legal standard would generate costly and uncertain inquiries into the parties' purpose in order to distinguish, as the proposed theory itself requires, ordinary exclusive-dealing agreements whose known consequence (but not "purpose") may be to drive a particular firm out of business.[7] Thus, any such approach, which is not supported by the Government, is unrelated to any presumptive harm to competition (as opposed to a competitor) and would violate this Court's commitment to "protecting the doctrine of *GTE Sylvania*" to preserve broad freedom for vertical nonprice agreements. *Sharp*, 485 U.S. at 726; *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). *See also* ABA Antitrust Section, *Statement on Discon v. NYNEX* at 5-7 (http://www.abanet.org/antitrust/discon.html).[8]

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[7] The *amicus* brief confirms the inevitable resulting uncertainty by its refusal to characterize the very agreement in this case. *Id.* at 9-11. Moreover, this Court and others have expressed criticism of any antitrust focus on "purpose" or "intent" separate and apart from the terms of any agreement or action and its actual and foreseeable effects. *See, e.g., Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 602-03 (1985); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983) (Breyer, J.) (rejecting reliance on plaintiff's claim that defendant " 'intended' to drive [plaintiff] from the market place").

[8] The *amicus* brief (at 8) incorrectly infers Professor Areeda's support for its proposal from one sentence discussing the dissent in *Sharp* (VIII P. Areeda, *Antitrust Law* ¶ 1625d (1989)), ignoring the immediately surrounding context of that sentence. Profesor Areeda did not endorse a *per se* rule for nonprice vertical agreements. *See also* P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 1644'c (Supp. 1997) (criticizing *Discon* decision).

The agreement challenged in this case is not only of a type that cannot be found "almost always" anticompetitive (*Sharp*, 485 U.S. at 723); it is not, on the facts alleged, anticompetitive at all. While Discon notes this Court's caution that dismissals before discovery "should be granted very sparingly" (*Hospital Building Co. v. Trustees of Rex Hospital*, 425 U.S. 738, 746 (1976), quoted at Discon Br. 21), such caution has never meant abdication where the standards for dismissal are met: dismissals in antitrust cases for insufficient factual allegations of required elements are anything but rare.[9] Discon thus recognizes that the district court is entitled to demand "some specificity in pleading before allowing a potentially massive factual controversy to proceed." *Associated Gen. Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 528 n.17 (1983), quoted at Discon Br. 13. Discon accepts that the dismissal standard " 'does not permit conclusory statements to substitute for minimally sufficient *factual* allegations' " (*Electronics Communications Corp.*, 129 F.3d at 243 (emphasis added)), which must themselves show, if ultimately supported by evidence, all of the "material elements necessary to sustain recovery under some viable legal theory" (*Car Carriers*, 745 F.3d at 1106, quoted at Discon Br. 13). Thus, "[b]ecause the antitrust laws were enacted for the protection of competition, not competitors," Discon's

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[9] *See, e.g., Electronics Communications Corp., supra* (2d Cir.); *SmileCare Dental Group v. Delta Dental Plan, Inc.*, 88 F.3d 780 (9th Cir.), *cert. denied*, 117 S. Ct. 583 (1996); *Dial-A-Car, Inc. v. Transportation, Inc.*, 82 F.3d 484 (D.C. Cir. 1996); *TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022 (10th Cir.), *cert. denied*, 506 U.S. 999 (1992); *Rutman Wine Co. v. E. & J. Gallo Winery*, 829 F.2d 729 (9th Cir. 1987); *Newman v. Universal Pictures*, 813 F.2d 1519 (9th Cir. 1987), *cert. denied*, 486 U.S. 1059 (1988); *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101 (7th Cir. 1984), *cert. denied*, 470 U.S. 1054 (1985); *Dunn & Mavis, Inc. v. Nu-Car Driveaway, Inc.*, 691 F.2d 241 (6th Cir. 1982); *Havoco of America Ltd. v. Shell Oil Co.*, 626 F.2d 549 (7th Cir. 1980).

amended complaint was required to "allege facts that would show an anticompetitive impact on the market as a whole." *Dial-A-Car*, 82 F.3d at 486. Discon's brief makes clear that its only theories of supposed competitive harm fail to meet that elemental standard. Accordingly, dismissal was proper.

1. *The Allegations Do Not Establish Harm To Competition In The Sale Of Telephone Service*

For two reasons, no finding of harm to competition in the telephone-service market can support the Second Circuit's ruling here. First, Discon has now vigorously and repeatedly disclaimed any such reliance on any anticompetitive effect in the telephone-service market. Rather, while continuing to rely on the alleged regulatory fraud to explain the alleged conduct, Discon now insists that all it has alleged, and all the Second Circuit found, was anticompetitive harm "in the removal services market" as a result of the alleged fraudulent overcharging of telephone-service ratepayers. Discon Br. 30; *see id.* at 3, 5-6, 9 n.6, 10, 14, 23 n.13, 29, 30-32. Indeed, Discon affirmatively suggests that any claim of harm to competition in the telephone-service market—in which Discon was not a competitor and where no effect on competition among rival sellers is at issue—would be legally wrong. *Id.* at 30-32. This insistent disclaimer is sufficient to remove any such claim from the case. The allegations of regulatory fraud remain only as Discon's own explanation of the conduct at issue—an explanation that, as noted below, decisively confirms that Discon has alleged only a fraud and not a *market*-constraint problem at all.

Second, and in any event, the idea that the alleged fraudulent overcharging of ratepayers brought about a *competitive* harm in the telephone-service market is patently incorrect. NYNEX's opening brief set out why that idea is both plainly wrong and pernicious. NYNEX Br. 27-36. No answer to this showing has been advanced.

In fact, Discon, far from disputing the analysis, has itself suggested that a reason for not reading the Second Circuit opinion to focus on competitive harm in the regulated market is that such a theory would be "counterintuitive." Discon Br. 32; *see id.* at 30-32.

Nevertheless, the Second Circuit is naturally understood to have relied on ratepayer overcharging as an anticompetitive effect, and the Government expressly endorsed that notion at the petition stage (SG Pet. Br. 8-12)—though it now has notably refused to readvance that ill-considered position. This Court should reject the theory on the merits. The theory is " 'novel' " (SG Br. 19) in that it is indefensible for long-recognized, simple, and compelling reasons: notably, regulatory fraud is not itself an antitrust problem and excess pricing by a lawful monopolist is not anticompetitive. NYNEX Br. 27-36. Despite the Government's plea (SG Br. 19), no further lower court development on the issue is needed. Meanwhile, the Government's initial legal position, elaborating the Second Circuit's apparent meaning, will inevitably cause mischief in litigation, having already attracted the attention of the antitrust bar. *See* Davis, "Discon v. NYNEX," *Antitrust* 53, 57 (Summer 1998). This Court should definitively lay it to rest.

2. *The Allegations Do Not Establish Harm To Competition, Rather Than Harm To A Particular Competitor, In The Sale Of Removal Services*

Discon accepts that, to survive dismissal, its allegations must be sufficient—without the addition of "facts that it has not alleged" (*Associated General Contractors*, 459 U.S. at 526)—to establish harm not just to itself but to competition marketwide and, moreover, that "this approach is often formulated as a requirement of proof of actual or threatened market power." Discon Br. 23-24; *see* NYNEX Br. 22 n.17. The necessary harm to marketwide competition requires allegations showing a threat that

buyers will be forced to accept supracompetitive prices as a result of an overall impairment of competitive alternatives from existing or potential competing sellers. Importantly, as has repeatedly been recognized, "without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time." *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 591 n.15 (1986); *see, e.g., Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 120 n.15 (1986); *United States v. Baker Hughes Inc.*, 908 F.2d 981, 987 (D.C. Cir. 1990) (Thomas, J.); *Dial-A-Car*, 82 F.3d at 488; *Los Angeles Land Co. v. Brunswick Corp.*, 6 F.3d 1422, 1425-26 (9th Cir. 1993), *cert. denied*, 510 U.S. 1197 (1994); *Ball Memorial Hospital, Inc. v. Mutual Hospital Ins., Inc.*, 784 F.2d 1325, 1335-36 (7th Cir. 1986).

Discon has done nothing to fill the decisive gaps in its allegations, making unsustainable any inference of marketwide harm, or even harm to other current or potential removal-services providers, from the facts alleged. In particular, Discon has no answer to the obvious lack of any significant entry barriers (or any nontrivial minimal scale of entry) in this low-technology business of dismantling and discarding telephone switching equipment. According to Discon itself, telephone companies can and do simply use their own employees to do this work; and Discon itself, within months of its formation, obtained a $500,000 contract and had 25 employees (with plans to triple). *See* NYNEX Br. 37-38. Moreover, Discon has said nothing about other existing and potential sellers of removal services and their prices. Nor has it said anything about effects on other buyers of removal services to the extent it has alleged a market beyond NYNEX as the sole buyer (Discon now concedes that Rochester Telephone, for example, is a buyer in the "removal services market," Discon Br. 39). Nor, finally, has Discon made any less implausible and strained its essential contention that NYNEX was agreeing to subject itself as a buyer to con-

stricted marketwide competition among suppliers of removal services—when such a result would be a form of self-inflicted injury, would be implausible to achieve given the absence of entry barriers (and its ability to do the work itself), and would be unnecessary to carry out the alleged fraudulent profit-making scheme.

Discon responds in essentially four ways, but the arguments merely confirm the insufficiency of the amended complaint's allegations. First, and most importantly, Discon repeatedly reveals the totality of its true basis for asserting competitive harm: nothing other than harm to itself as a competitor. Discon states in a section heading: "competitive harm alleged by Discon was *its* exclusion from the unregulated supplier markets." Discon Br. 29 (emphasis added; capitalization omitted). In its initial section on "allegations of harm to competition" (Discon Br. 21 (capitalization omitted)), Discon concludes: "the effect is the elimination of a competitor and, consequently, elimination of competition." *Id.* at 23. *See also id.* at 27 ("The 'nature and effect' of the alleged conspiracy was to effect the exclusion of a competitor from, *and thus lessen competition in*, the market for removal services.") (emphasis added); *id.* at 10 ("The anti-competitive effect of the conspiracy was the suppression of competition in the unregulated removal services supplier market by the exclusion of Discon."). Without any allegations as to other sellers or entry barriers in this disposal business, and with the challenged conduct explainable without regard to any marketwide harm to competition, Discon is reduced to complaining of nothing more than its own harm. Nothing is better settled in antitrust law than that such harm is not harm to competition. *See* NYNEX Br. 15, 23-24.

Second, Discon briefly relies on the allegation that some prices paid by NYNEX were higher as a result of the alleged agreement. Discon Br. 22. In addition to saying nothing about prices to other buyers (or market prices

generally), however, that allegation does not, in this case, imply any *market*-constraint problem at all. Discon's own allegations of a regulatory-evasion scheme provide a complete explanation of such raised prices (*e.g.*, Discon Br. 35, 39), thus removing any basis for inferring that the alleged prices resulted from market constraints in the sale of removal services. One buyer's choice to pay higher prices, fully explicable without regard to impaired competition, in a market without entry barriers (or shortage of other sellers), does not show harmed *competition*.

Third, Discon repeatedly relies on the allegation that NYNEX (specifically, MECo) had to certify which suppliers would be allowed to sell to it. Discon Br. 24-26, 32-34; *e.g.*, *id.* at 34 ("Discon, as well as other vendors, had to be approved by MECo"). The significance of that allegation is a mystery. Every firm has the power to decide, and must decide, who will be its suppliers. And even the exercise of that power to choose a single supplier could not imply anticompetitive effects, for that is the choice made in every exclusive-dealing situation. Here, there is no allegation that NYNEX's certification decisions for itself blocked choices by other buyers of removal services, either legally or by way of some relevant minimum scale of entry for this business.

Fourth, Discon argues that it is economically plausible that NYNEX would have engaged in the alleged regulatory fraud. Discon Br. 35. Discon has attacked a straw man. The point is not that the conduct is implausible. Nor is it that, in the abstract, a buyer can never rationally foster a seller's market power—even when, as conceded here, it is cost-imposing to do so (SG Br. 28)—or that implausibility of a buyer's self-infliction of injury, standing alone, sets a "heightened pleading standard" (SG Br. 23) or always requires dismissal. Rather, the point is that the very profit-making mechanism of regulatory fraud alleged by Discon did not plausibly require NYNEX to limit (as it could not plausibly do in any event) its future ability to

buy removal services at competitive prices whenever it wished (from existing sellers or readily available new entrants).[10] And that implausibility of a nexus between the alleged fraud scheme and self-injuring creation of supply-market harm confirms that, in this setting, the utter absence of alleged entry barriers or other bases for inferring marketwide harm leaves the "specificity" standard of *Associated General Contractors* unsatisfied.

In the end, Discon's argument confirms that it has alleged no more than a regulatory fraud resulting in harm to it, and it alone. There are no allegations of facts sufficient to show harm to marketwide competition. Because the freedom to change suppliers is at the core of competition, this Court must insist upon such allegations if the antitrust laws are not to be used by suppliers to deter their termination and thus undermine the process of competition itself. Discon has had ample opportunity to advance a sustainable theory of anticompetitive harm that might warrant continuing costly litigation on its amended complaint. It has failed to do so. Dismissal was proper.

II. THE SECOND CIRCUIT'S SECTION 2 HOLDING SHOULD BE REVERSED

Discon's efforts to preserve its Section 2 conspiracy-to-monopolize claim are as unsound as its Section 1 arguments. As with its Section 1 defense, Discon attempts to limit the scope of the question presented and also defends the Second Circuit's ruling on its merits. Both arguments should be rejected.

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[10] Neither Discon nor the Government provides a realistic explanation of how an effort to eliminate Discon or other removal-services competitors to AT&T could reasonably succeed (given the nature of the work and the ease of entry) or how such a futile effort would significantly advance the alleged regulatory fraud. Presumably, the worse a firm like Discon was hurt, and the greater the number of such injured suppliers, the *more* likely regulatory officials would be to hear complaints, as they in fact did from Discon.

A. Discon briefly suggests (Discon Br. 38), following the Government (SG Br. 24-25), that the second question presented is limited to whether any agreement by a purchaser to buy from one supplier rather than another "*ever*" can be a conspiracy to monopolize (*id.* at 24). But this argument gives an unfair—because distinctly implausible—reading to the question, interpreting it to make only an extraordinary request for *per se legality* under Section 2 of all supplier-change agreements, no matter what their content or circumstances. Moreover, because the abstract question whether a supplier-change agreement could "ever" be a Section 2 conspiracy would be almost nonsensical, consideration of the particular facts here is a "predicate to an intelligent resolution" of the question of Section 2 conspiracy standards [11]—as Discon fully accepts for the similarly phrased *first* question presented. *See* Discon Br. 14-17, 20; Br. in Opp. 8-14; *see also* SG Br. i, 11, 15. In these circumstances, the question presented properly includes whether the "central premise of the question and the assumption on which it is based" apply in the particular case [12]—here, whether the agreement alleged is legally distinguishable, for Section 2 conspiracy purposes, from the ordinary purchaser agreement to buy from one supplier rather than another. Not surprisingly, then, Discon's brief in opposition focused on the particular agreement, arguing that it differed from the usual supplier-change agreement and never suggesting that

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[11] *Vance v. Terrazas*, 444 U.S. 252, 258 n.5 (1980); *see, e.g., Caterpillar, Inc. v. Lewis*, 117 S. Ct. 467, 476 n.13 (1996); *Ohio v. Robinette*, 117 S. Ct. 417, 420 (1996).

[12] *Bragdon v. Abbott*, 118 S. Ct. 2196, 2210 (1998). In *Bragdon*, this Court readily treated a question presented that asked whether courts "should defer to the health care provider's professional judgment, as long as it is reasonable in light of then-current medical knowledge" (*see id.* at 2209-10) as including "the implicit assumption in the question presented, whether [the particular health care provider's] actions were reasonable," thus embracing "the application of the rule to the facts of this case." *Id.* at 2211; *see id.* at 2209-13.

only an abstract "can it ever be" question was presented. Br. in Opp. i, 14-15; *see Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 266 n.12 (1992). Thus, the question presented is whether the allegations in this case, if proved, could support liability for conspiracy to monopolize under Section 2.

B. On the merits, the Section 2 claim fails because the Section 1 claim fails. Discon nowhere disputes, and the Government expressly agrees, that, if the alleged agreement cannot give rise to Section 1 liability for conspiracy in restraint of trade, then *a fortiori* it cannot give rise to Section 2 liability for conspiracy to monopolize. SG Br. 20 n.12. This principle, resting on the elementary proposition that an agreement to create or maintain a monopoly by exclusionary means is an anticompetitive agreement (NYNEX Br. 40), states an essential limit on the little-used portion of Section 2 that addresses concerted action. Section 2 has never been and should not now become an avenue for an antitrust plaintiff to evade the fundamental Section 1 requirement of proving constriction of the market, substituting a pure "specific intent" standard that could generate costly discovery and uncertain litigation if there were no threshold objective standards requiring actual or realistically threatened marketwide impact. A contrary conclusion would vitiate the protections for market freedom established by the important limits on antitrust liability under Section 1. Because the Section 1 standards are not satisfied, for all the reasons previously explained, Discon's Section 2 conspiracy claim —which "amounts to nothing more than its § 1 claim under another name" (*FLM Collision Parts, Inc. v. Ford Motor Co.*, 543 F.2d 1019, 1030 (2d Cir. 1976), *cert. denied*, 429 U.S. 1097 (1977))—must be dismissed as well.

Discon's Section 2 conspiracy claim also must directly fail, for two reasons. First, as the Government seems to acknowledge (SG Br. 29), and Discon does not deny, its

amended complaint does not, fairly read, allege that the object of the alleged conspiracy was to make AT&T a seller of removal services with monopoly power. Rather, as Discon told the Second Circuit, the allegation was that *NYNEX* would be the monopolist—an allegation that the Second Circuit properly rejected (and that is not defended here). *See* NYNEX Br. 11 n.12, 41. The Section 2 conspiracy claim cannot be resurrected on the basis of "facts that it has not alleged." *Associated General Contractors*, 459 U.S. at 526.

Second, and in any event, Discon accepts that it must prove "a specific intent to monopolize a market, that is intent to create or maintain a monopoly by improper means." Discon Br. 36. This Section 2 conspiracy standard, which has rarely been addressed by this Court, must be applied to ensure protection against chilling of procompetitive changes of suppliers. The Court has repeatedly acted to ensure such protection for firms' marketplace freedom in other contexts, setting a demanding standard that rejects evidence as legally insufficient when it is no more than ambiguous in implying that the challenged conduct or specific agreement occurred. *See, e.g., Sharp*, 485 U.S. at 726; *Matsushita*, 475 U.S. at 594; *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763-64 (1984). Similarly here: extensive discovery and litigation should not be allowed to proceed on the basis of bare allegations of a specific intent to monopolize or, worse, allegations of facts that make an intent to create and maintain monopoly power by exclusionary means *less* plausible even than the alternative explanation of the conduct laid out in the amended complaint.

Under such a properly established standard for Section 2 conspiracy, the allegations in this case are inadequate. The factual allegations, if proved, would be worse than ambiguous in supporting a claim of specific intent to monopolize: (1) there are no plausible entry barriers that could sustain monopoly power; (2) a buyer like NYNEX has a distinct *dis*incentive to confer monopoly power on an independent firm and thus put itself at that firm's mercy; and (3) the alleged regulatory-fraud profit-making scheme functions without creation of such monopoly power.[13] Permitting expensive litigation to proceed in the face of such facts would undermine the purposes of the antitrust laws. The Section 2 conspiracy claim must fail.

CONCLUSION

The judgment of the court of appeals should be reversed, and the district court's dismissal order reinstated.

Respectfully submitted.

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
1850 M Street, NW
Washington, DC 20036
(202) 775-0184

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

August 14, 1998

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[13] Discon and the Government rely on *Olympia Equip. Leasing Co. v. Western Union Tel. Co.*, 797 F.2d 370, 374 (7th Cir. 1986), *cert. denied*, 480 U.S. 934 (1987), for the notion that a regulated monopolist may have an incentive to create an upstream monopoly. Discon Br. 40; SG Br. 26. But *Olympia* was talking about such a firm's incentive to make *itself* an upstream monopolist—Discon's original theory, which the Second Circuit rejected. That is a far cry from the allegation here: creating monopoly power in an independent firm that could then use it to exploit its buyers. We are aware of no precedent finding the latter allegation plausible or sustaining an antitrust claim based on it.

Supreme Court, U.S.
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No. 96-1570

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES COMPANY,
and NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON, INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR PETITIONERS

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
1850 M Street, NW
Washington, DC 20036
(202) 775-0184

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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QUESTIONS PRESENTED

When a Purchaser agrees to buy from Supplier A rather than Supplier B, and there is no issue of any horizontal restraints or vertical price restraints:

1. May the agreement between Purchaser and Supplier A be characterized as a group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?

2. May the agreement between Purchaser and Supplier A be characterized as a conspiracy to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2?

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On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 93 F.3d 1055. The opinion of the district court dismissing the amended complaint (Pet. App. 21a-53a) is not reported. The opinion of the district court dismissing the original complaint (J.A. 42-72) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 26, 1996. Pet. App. 1a; J.A. 124-25. A petition for rehearing, with a suggestion for rehearing en banc, was denied on January 7, 1997. Pet. App. 54a-55a. The petition for writ of certiorari was filed on April 4, 1997. This Court has jurisdiction under 28 U.S.C. §§ 1254(1)

and 2101(c). The Court granted the petition for a writ of certiorari on March 23, 1998. J.A. 126.

STATUTES INVOLVED

Section 1 of the Sherman Act, 15 U.S.C. § 1, provides in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.

Section 2 of the Sherman Act, 15 U.S.C. § 2, provides in pertinent part:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony * * *.

STATEMENT

Respondent Discon, Incorporated, was a supplier to telephone companies of removal services, *i.e.*, "the salvage and disposal of obsolete telephone central office equipment." J.A. 78 (Amended Complaint ¶ 13). Petitioner NYNEX Corporation was the parent corporation of petitioner New York Telephone Company (NYT), which provided regulated telephone service in New York, and of petitioner NYNEX Materiel Enterprises Company (MECo), a subsidiary that acted as a purchasing agent for NYNEX and its affiliates.[1] For two years in the mid-

[1] Except where relevant to distinguish among them, petitioners are referred to collectively as NYNEX.

The information required by Rule 29.6 of this Court's Rules, concerning parent companies and nonwholly owned subsidiaries, is set forth at Pet. ii-iii, supplemented by the fact that NYNEX Corporation is now a subsidiary of Bell Atlantic Corporation. All the current parties to the proceeding are listed in the caption. Two additional named defendants, Robert Eckenrode and Bernard O'Reilly, were not named in the Sherman Act counts at issue in this Court; all of the counts naming them have been dismissed.

1980s, Discon sold removal services to NYNEX, either directly to NYT or through MECo. Several years after NYNEX stopped buying removal services from it, Discon sued for treble damages under the Sherman Act, 15 U.S.C. §§ 1, 2, 15. The Second Circuit held that Discon had stated two valid antitrust claims, for conspiracy in restraint of trade and conspiracy to monopolize.

NYNEX challenges that ruling. The Second Circuit relied on inapplicable categories of antitrust law and mistreated as an antitrust problem what is at most an alleged fraudulent evasion of other regulatory regimes governing rates in the telephone-services market, which is not even alleged as a relevant antitrust market here. In so doing, the court authorized costly antitrust litigation over a firm's replacement of one of its suppliers even though there are no specific and plausible allegations of any harm to competition (as opposed to harm to Discon alone) in the removal-services markets actually alleged.

A. Background

In 1990, Discon filed a 16-count complaint including claims of conspiracy to restrain trade, monopolization, attempted monopolization, and conspiracy to monopolize. J.A. 3-41.[2] After the district court dismissed the complaint with leave to replead, Discon filed an amended complaint. J.A. 42-72, 73-123. Because the issue before this Court is whether the amended complaint was properly dismissed, the allegations in that complaint are assumed to be true.

The antitrust claims at issue do not involve any market in which NYNEX is a seller of telephone services to consumers. Rather, they involve a single product, namely, removal services, sold by Discon in two alleged markets—"the markets for removal services [1] at NYT and [2] in

[2] Discon also presented claims under the Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. § 1962, and numerous state-law claims. All of the non-antitrust claims have been dismissed and are no longer in the case.

the New York State area." J.A. 112 (Am. Compl. ¶ 107, conspiracy to monopolize); J.A. 112 (Am. Compl. ¶ 110, conspiracy to restrain trade) (bracketed numbers added).[3] AT&T was allegedly "the dominant supplier of removal services in New York State." J.A. 82 (Am. Compl. ¶ 26). At the same time, according to Discon, AT&T and NYNEX, as telephone companies, were the "only major *purchasers* of removal services in New York State." J.A. 76 (Am. Compl. ¶ 2) (emphasis added); *see* J.A. 83 (Am. Compl. ¶ 29). *See also* J.A. 111 (Am. Compl. ¶ 104) (NYNEX "effectively controlled the price at which contracts for removal services were obtained").

Beginning in 1984 and until mid-1986, NYNEX bought some removal services from the newly formed Discon—specifically, NYT bought the services either directly or through MECo, the NYNEX purchasing agent—while also buying such services from AT&T. *See* J.A. 87-90 (Am. Compl. ¶¶ 40-52). Many telephone companies, including NYNEX, rather than buying all of their removal services from outside sellers, used their own employees for much of this kind of dismantling and disposal work. J.A. 83 (Am. Compl. ¶ 27). Even while using Discon, NYNEX assigned AT&T "supervisory and quality control responsibilities" for at least some of the Discon projects. J.A. 85-86 (Am. Compl. ¶¶ 33, 36).

In 1986, NYNEX stopped buying from Discon. J.A. 91 (Am. Compl. ¶¶ 53, 55). The amended complaint itself identifies a basis for the termination (which has been denied by Discon): improper conduct by Discon. In particular, NYNEX learned that Discon had lent money to a NYNEX contracting officer without expectation of

[3] The definition of the relevant product markets as markets for removal services purchased by telephone companies like NYNEX is repeated throughout the amended complaint, including in all of the antitrust claims. *See, e.g.*, J.A. 75-76 (Am. Compl. ¶¶ 1-3), 80 (Am. Compl. ¶ 20), 82, 83 (Am. Compl. ¶ 29), 84 (Am. Compl. ¶¶ 32-33), 91 (Am. Compl. ¶ 55), 110 (Am. Compl. ¶¶ 98-99, attempt to monopolize), 111 (Am. Compl. ¶ 104, monopolization).

repayment, then hired that contracting officer once he left NYNEX. *See* J.A. 85, 90-91, 121-22 (Am. Compl. ¶¶ 33(a), 50, 53, 165-66).

Discon, however, alleged that its termination as a supplier to NYNEX was the result of a conspiracy between NYNEX and AT&T, which the amended complaint—while alleging no more than an agreement that NYNEX would buy from AT&T rather than Discon—characterizes as an agreement to "discriminate against Discon" and "to exclude Discon from the market." J.A. 84 (Am. Compl. ¶¶ 33, 31). As a result of its termination, Discon alleged, NYNEX "agreed to award [AT&T] *most* contracts on a non-competitive basis" (J.A. 84 (Am. Compl. ¶ 31)) and to "award *virtually all* its contracts" for removal services to AT&T (J.A. 112, Am. Compl. ¶ 110). (Emphases added.) *Cf.* J.A. 76 (Am. Compl. ¶ 3 (NYNEX "awarded contracts to AT&T on a preferential or exclusive basis")). In this Court, Discon has characterized its amended complaint, not as alleging a full "requirements" contract or other exclusive-dealing contract between NYNEX and AT&T, but as alleging that AT&T provided "the lion's share" of removals needed by NYNEX. Br. in Opp. 5.[4]

Although the amended complaint alleges harm to Discon as an individual competitor,[5] it contains no allegations

[4] Discon did not name AT&T as a defendant in this case. (Although the amended complaint distinguishes AT&T Technologies, which provided removal services, from AT&T Communications, which sold long-distance telephone service, the two companies are properly treated as the single entity, AT&T.) A separate lawsuit by Discon against AT&T was dismissed with leave to replead, but Discon did not replead or appeal. Decision and Order, *Discon, Inc. v. AT&T Technologies*, No. 90-545A (W.D.N.Y. June 25, 1992).

Discon's claim of a Section 2 conspiracy to monopolize also alleges two other conspirators, LISN (a seller of removal services) and Robert McGee, a subcontractor in Buffalo. *See* J.A. 111-12 (Am. Compl. ¶ 107), 85 (Am. Compl. ¶ 33(a)).

[5] Discon's termination as a supplier to NYNEX allegedly "restrained Discon from competing in markets for removal services

about exclusion of other competitors selling removal services, about any resulting constriction of supply that harmed the buyers in the markets for removal services (*i.e.*, telephone companies), or about barriers to new entry into this business. Significantly, in light of what is thus *not* alleged, the amended complaint itself refers to other present and potential suppliers of removal services (J.A. 111 (Am. Compl. ¶ 107) and notes that telephone companies often use their own employees to do this work (J.A. 83 (Am. Compl. ¶ 27)). Moreover, Discon's original complaint details Discon's own quick entry and rapid expansion: Discon was formed in June 1984, won a $500,000 contract in its first month, and, within only six months, had 25 employees and was planning to hire 50 more. J.A. 15, 17 (Compl. ¶¶ 50, 52, 61); *see* J.A. 87 (Am. Compl. ¶ 40, 1984 contract).

The amended complaint explains the alleged NYNEX-AT&T agreement to replace Discon as a supplier to NYNEX, not in familiar antitrust terms as an effort driven by Discon's competitor (AT&T), but rather as a scheme undertaken by NYNEX to engage in regulatory fraud as a seller of telephone services. According to Discon, the goal of the purported agreement was to enable NYNEX to evade regulatory limits on its rates in the distinct market for telephone services sold by NYNEX (specifically, NYT) under cost-of-service regulation imposed by the New York Public Service Commission and Federal Communications Commission. J.A. 76, 83, 93-94 (Am. Compl. ¶¶ 2, 29, 64). In particular, NYNEX allegedly agreed to buy removal services from AT&T at artificially high prices,

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and injured it in its business." J.A. 91 (Am. Compl. ¶ 55). *See* J.A. 92, 112-13 (Am. Compl. ¶¶ 58, 108, 113). The amended complaint does not indicate why termination of Discon as a supplier to NYNEX prevented it from selling removal services elsewhere. *See* J.A. 91 (Am. Compl. ¶ 53, proposed work for BellSouth). Discon's home base in Buffalo is no closer to New York City, which is within the alleged markets, than to various points (*e.g.*, in Ohio, Pennsylvania, Rochester, etc.) served by telephone companies other than NYNEX.

which were then incorporated into the cost basis for setting telephone-service rates, thus fooling the state and federal regulators into allowing inflated telephone rates; later, NYNEX allegedly received a secret rebate from AT&T to reduce the initially excessive price for removal services. *Id.*[6] Allegations that NYNEX had made excessive payments for certain equipment and services purchased through its MECo subsidiary, and thereby secured inflated regulatory rates, were the specific subject of federal and state regulatory proceedings, although no findings were made either that NYNEX had committed fraud or that NYNEX had improperly used AT&T rather than Discon for its removal services.[7] The amended complaint alleges that the regulators' rate adjustments were inadequate to compensate Discon and other ratepayers. J.A. 94-95 (Am. Compl. ¶¶ 68, 70).[8]

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[6] The amended complaint alleges that excess prices were paid both on direct purchases by NYT and on purchases made through MECo. J.A. 84, 93-96 (Am. Compl. ¶¶ 31, 64-73). As the Solicitor General has pointed out, the amended complaint does not explain the relationship between the alleged scheme to defraud regulators through excessive prices and Discon's alleged exclusion from the removal-services business. *See* Brief for the United States and FTC on Petition for Certiorari at 8 n.4 (hereafter SG Pet. Br.).

[7] *See New York Telephone Co.*, 5 F.C.C.R. 866 (1990) (initiating enforcement action for alleged "unreasonable markups and overcharges by MECO"); 5 F.C.C.R. 5892 (1990) (settlement of proceeding by payment of refund); *New York Telephone Co.*, 31 N.Y.P.S.C. 485, 511-13 (1991), *aff'd sub nom. New York Telephone Co. v. Public Service Comm'n*, 190 A.D.2d 217, 597 N.Y.S.2d 760 (3d Dep't 1993).

Whether an unregulated affiliate is limited to the regulated utility's prescribed rate of return has been a recurrent regulatory issue (*see* 5 F.C.C.R. at 867-68), and whether particular expenditures are reasonable is an issue endemic to traditional rate-of-return utility regulation (*see* 190 A.D.2d at 220-24, 597 N.Y.S.2d at 761-63). Rejection of a utility's position in either regard does not imply fraud on the utility's part.

[8] In addition to suing as a competitor in the removal-services markets, Discon sued as a ratepayer buying telephone service from

Based on those allegations, Discon claimed that NYNEX and AT&T violated Section 1 by agreeing "to fix prices and to restrict competition in the markets for removal services at NYT and in the New York State area." J.A. 112 (Am. Compl. ¶ 110). Discon also made three claims under Section 2 of the Sherman Act—which are comprehensible only on Discon's theory that NYNEX's wholly owned subsidiary MECo, which acted as a purchasing agent and did not provide any removal services of its own, was a separate entity acting as a supplier of removal services in competition with Discon.[9] Discon alleged that the NYNEX companies had "attempted to monopolize" the removal-services markets (J.A. 110 (Am. Compl. ¶ 100)) and had succeeded in monopolizing the removal-services markets (J.A. 111 (Am. Compl. ¶ 104)) and, also, that the NYNEX companies "combined and conspired with others, including [AT&T and two other removal-services providers], with the specific intent to violate Section 2 of the Sherman Act by monopolizing" the same markets. J.A. 111-12 (Am. Compl. ¶ 107). The amended

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NYNEX (*e.g.*, J.A. 77, 113 (Am. Compl. ¶¶ 3, 113)), but the district court dismissed those claims as barred by the filed rate doctrine (Pet. App. 32a), and Discon did not appeal that ruling. The amended complaint also makes reference to NYNEX's purchase of certain computer and other equipment (*e.g.*, J.A. 76, 92 (Am. Compl. ¶¶ 2, 59)), but the counts stating the antitrust claims (J.A. 110-113 (Am. Compl. ¶¶ 97-113)) do not involve markets for such equipment, which do not appear to have anything to do with Discon. The case, accordingly, is only about the alleged markets for removal services.

[9] MECo, a wholly owned subsidiary of NYNEX, acted only as a *purchasing* agent for the NYNEX companies (*see, e.g.*, J.A. 79 (Am. Compl. ¶ 16)), and "[i]t is undisputed that MECo itself [did] not perform any removal services for NYTel" (Pet. App. 8a). As the Solicitor General has acknowledged, in agreement with the Second Circuit (Pet. App. 8a-10a), the various NYNEX petitioners are properly treated as a single entity. *See* SG Pet. Br. 2 n.1.

complaint seeks damages that "exceed $75 million." J.A. 123 (Am. Compl. ¶ 173).

B. The Court of Appeals Decision

After the district court dismissed the amended complaint (Pet. App. 21a-52a), the Second Circuit reversed. Pet. App. 1a-20a. The court of appeals agreed with most of the district court's rulings, including its dismissal of the claims of monopolization and attempted monopolization. Pet. App. 15a-20a. Nevertheless, relying on new theories not presented by Discon, the court of appeals reinstated the amended complaint's claims of Section 1 conspiracy and Section 2 conspiracy.

As to Section 1, the court of appeals first held that the district court had correctly rejected Discon's attempt to characterize its allegations of a NYNEX-AT&T agreement as involving a *horizontal* agreement. It explained that MECo was wholly owned by and acted only as a purchasing agent for NYNEX, so that the NYNEX companies were properly treated as a single entity that was only a purchaser of removal services from Discon and AT&T, not a competitor of Discon and AT&T in the market for the sale of such services. Pet. App. 8a-10a (rejecting characterization of MECo as distinct from NYNEX, relying on *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) (corporate family treated as single entity for antitrust purposes)). Having established that the alleged agreement is only a *vertical* one, the court of appeals next rejected Discon's attempt to characterize the agreement as one to fix prices under this Court's *per se* rule against vertical agreements to set minimum resale prices (*see Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 724 (1988)). Pet. App. 10a n.5.[10]

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[10] Removal services were not to be resold by NYNEX at all. In its brief in opposition to the petition for certiorari, Discon did not dispute the Second Circuit's rejection of its "theory of vertical price-fixing" (Pet. App. 10a n.5).

The court of appeals nevertheless ruled that "Discon may be able to prevail under a different legal theory" in challenging the alleged vertical nonprice agreement between NYNEX and AT&T. Pet. App. 10a. Although Discon had not cited *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the court held that the group boycott (or concerted refusal to deal) doctrine of *Klor's* might be "extended . . . to the situation where only a single retailer and a single manufacturer conspire." Pet. App. 11a. The court acknowledged that "such arrangements will often resemble exclusive distributorship agreements, which are generally considered permissible under the rule of reason," and that "*in general*, two-firm vertical combinations will be scrutinized as exclusive distributorship controversies, rather than as group boycotts." Pet. App. 12a. The court further recognized, relying on *Sharp*, that "[i]n the vast majority of cases, the decision to discriminate in favor of one supplier over another will have a pro-competitive intent and effect." *Id.* But the court held that no "pro-competitive rationale appears on the face of the complaint," which alleges only an "intent and effect" to "overcharge captive rate-paying customers." *Id.* Without inquiry into whether the amended complaint alleged any harm to competition (rather than to Discon) in the alleged markets for removal services, the court held: "Discon has alleged a cause of action under, at least, the rule of reason, and possibly under the *per se* rule applied to group boycotts in *Klor's*, if the restraint of trade has no purpose except stifling competition." Pet. App. 13a (internal quotation marks omitted).[11]

As to Section 2, the court of appeals quickly disposed of Discon's claims that NYNEX had monopolized and

[11] On the "pro-competitive" side of the inquiry, the court attached a footnote simply declaring that the "traditional rationale for applying the rule of reason to two-firm group boycotts—the promotion of interbrand competition over intrabrand competition—does not exist in this case." Pet. App. 13a n.6.

attempted to monopolize the alleged markets for removal services, explaining that NYNEX was not a competitor or would-be competitor in the alleged markets at all and, therefore, could not be an actual or threatened monopolist. Pet. App. 13a-14a. The court of appeals then revived Discon's Section 2 claim of conspiracy to monopolize, though on a basis it made up on its own. Discon had claimed that the conspiracy was to make *NYNEX* the monopoly provider of removal services,[12] but that theory was also subject to the fatal defect that NYNEX was not a provider of removal services at all. The Second Circuit therefore recharacterized the Section 2 conspiracy claim as alleging that NYNEX entered into an agreement with the specific intent to give *AT&T* monopoly power as a seller of removal services (to, *e.g.*, NYNEX itself). Pet. App. 15a. On that basis the court revived the Section 2 conspiracy claim along with the Section 1 conspiracy claim.

On NYNEX's petition for a writ of certiorari, this Court invited the Solicitor General to express the views of the Government. The Government declined to defend the boycott rationale of the Second Circuit, but it defended the Section 1 result under a rule-of-reason theory based on regulatory evasion as an antitrust offense and urged denial of review. SG Pet. Br. 7-12, 18-20. This Court granted certiorari on March 23, 1998. J.A. 126.

INTRODUCTION AND SUMMARY OF ARGUMENT

A buyer's freedom to replace one supplier with another is the engine prodding rival suppliers to lower cost and improve quality and, thus, is the essence of a competitive economy. The Second Circuit's decision in this case cre-

[12] *See* J.A. 111-12 (Am. Compl. ¶ 107); Discon C.A. Br. 27 (MECo and AT&T conspired and "took overt acts in concert with the specific intent to have MECO monopolize the central office removal market in New York"); Discon C.A. Reply Br. 7 ("MECO attempted to, and did, monopolize the removal market, as well as conspire to monopolize it").

ates antitrust standards under both Section 1 and Section 2 of the Sherman Act that threaten this essential freedom. By allowing a disappointed supplier to impose the burdens of costly treble-damages antitrust litigation on its former purchaser in the absence of any specific and plausible allegation of any threat to competition in the supplier markets, the decision chills efficient supplier changes and thereby harms the very competitive process the antitrust laws are designed to protect.

I. The Second Circuit improperly invoked the antitrust category of group boycott, or concerted refusal to deal, in allowing the Section 1 conspiracy claim to proceed. That invocation is plain error. A group boycott is a subspecies of horizontal agreement, *i.e.*, an agreement between rivals, and the law of boycotts reflects the distinctive antitrust concern with such combinations of direct competitors. This case involves only an alleged vertical agreement between a purchaser (NYNEX) and a supplier (AT&T), making the law of group boycotts inapplicable.

The Second Circuit was mistaken not only in its labeling but in its substance. The alleged vertical nonprice agreement cannot be subject to a *per se* standard of liability. As this Court has repeatedly made clear, including in *State Oil Co. v. Khan*, 118 S. Ct. 275, 281 (1997), *Sharp, supra,* and *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), a vertical nonprice agreement between a purchaser and its supplier typically serves wholly legitimate purposes and is therefore subject to the rule of reason, which requires a Section 1 plaintiff to make proper allegations of and to prove harm to competition. Those requirements are essential to protecting business freedom against burdensome suits by disappointed suppliers.

Contrary to the Second Circuit's suggestion, the alleged harm in the market in which NYNEX sells telephone

service does not satisfy the requirement of harm to competition. That market is not alleged in the amended complaint as a relevant market, and rightly so, for the alleged fraudulent overcharging of ratepayers is not an antitrust concern: indeed, it had nothing to do with harming any competitive activity among rival sellers of telephone services at all. The necessary inquiry is whether competition was harmed in the only relevant markets, the alleged markets for removal services sold to NYNEX and in the New York State area.

As to those markets, however, there are critically missing allegations of harm to competition, not competitors: more than harm to Discon, but harm to the range of existing and potential rival sellers of removal services marketwide, thus harming the buyers in the market (*i.e.*, telephone companies) by subjecting them to diminished output and higher prices protected by entry barriers. This void in Discon's claims cannot be discounted as mere insufficient detail. Any suggestion of entry barriers or other facts needed to imply overall market harm would be inconsistent with Discon's own pleadings. Moreover, it is inherently implausible as an economic matter to suggest, as the Second Circuit did, that NYNEX would agree to subject itself to such exploitation at the hands of sellers in a constricted market for removal services. In these circumstances, to ensure adequate protection for the vital freedom of buyers to change suppliers, the omissions of essential facts indicating harm to competition, not competitors, should be determinative and require dismissal of Discon's Section 1 claim.

II. The Second Circuit's reinstatement of Discon's claim of Section 2 conspiracy is subject to the same flaw and others. Because a conspiracy to monopolize here would be a conspiracy in restraint of trade in violation of Section 1, the failure of the allegations of Section 1 conspiracy defeats the Section 2 conspiracy claim. The little-used claim of Section 2 conspiracy should not be permit-

ted to reopen the very avenues for abusive antitrust litigation foreclosed by a proper dismissal of the Section 1 claim.

In addition, the Second Circuit erred in reviving the Section 2 claim based on its own theory that NYNEX conspired to give *AT&T* a monopoly in the markets for removal services. The conspiracy-to-monopolize claim of the amended complaint is not fairly read to make such an allegation. Rather, as Discon made explicit in the court of appeals, that claim alleges that *NYNEX* would be the monopolist, in precise parallel with the monopolization and attempted-monopolization claims. All three Section 2 claims rested on Discon's attempt to separate MECo from NYNEX, and once the Second Circuit correctly rejected that attempt, it should have dismissed the conspiracy-to-monopolize claim for the same reason it dismissed the other Section 2 claims: because NYNEX was not an actual or planned seller in the relevant markets at all (much less a would-be monopolist).

Finally, even if Discon had presented the claim formulated by the Second Circuit, the factual allegations of its amended complaint cannot fairly be held to satisfy the essential requirement for a conspiracy to monopolize claim—that the parties conspired with the specific intent to give AT&T a monopoly. The entire amended complaint rests on the theory that the specific intent of the parties to the conspiracy was for NYNEX to engage in regulatory evasion and for AT&T to share in the spoils. Since that alleged scheme does not depend on AT&T's becoming a monopoly provider of removal services, and since it would be economically irrational for NYNEX to give monopoly power to AT&T, a specific intent to create such a monopoly cannot be supported on the facts alleged in the amended complaint.

ARGUMENT

This is a case of alleged regulatory fraud masquerading as an antitrust case. P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 1644'c, at 726-28 (Supp. 1997). The alleged overcharging of ratepayers, however wrongful as a regulatory matter, is not even alleged to harm any competitive activity, any rivalry between competing sellers, in the telephone-service market. This alleged ratepayer harm therefore is simply outside the ambit of antitrust law, which does not address all wrongs against consumers or all raising of price, but only a subset arising from impairments to the process of rivalry among firms, *i.e.*, competition. The only proper focus, accordingly, is on the removal-services markets actually alleged in the amended complaint. Although Discon has alleged harm to itself in those markets, "[i]t is axiomatic that the antitrust laws were passed for 'the protection of *competition*, not *competitors*.'" *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)). Discon has failed to meet that standard, for there are critically missing allegations of present or threatened curtailment of supply and raising of price, protected by entry barriers, through the squelching of existing and readily available competition in the alleged removal-services markets.

Under the proper legal standards requiring actual or threatened harm to marketwide competition, the district court's dismissal of both the Section 1 and Section 2 conspiracy claims was proper, and the Second Circuit's reinstatement should be reversed. Because this antitrust case, like others, has come to the Court on a motion to dismiss,[13]

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[13] *E.g.*, *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993); *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322 (1991); *Hoover v. Ronwin*, 466 U.S. 558 (1984); *Associated General Contractors of*

the Court "must assume that the [plaintiff] can prove the facts alleged in its amended complaint." *Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 526 (1983). "It is not, however, proper to assume that the [plaintiff] can prove facts that it has not alleged or that the defendants have violated the antitrust laws in ways that have not been alleged." *Id.* (footnote omitted, noting plaintiff's "adequate opportunity to amend its pleading"). Moreover, careful attention to what is alleged and what is not alleged is necessary to prevent the burdens and risks of litigation from undermining antitrust law's very objectives by chilling legitimate changes of suppliers and other procompetitive marketplace conduct: it is appropriate on a motion to dismiss "in a case of this magnitude . . . to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed." *Id.* at 528 n.17.

I. THE AMENDED COMPLAINT DOES NOT STATE A VALID CLAIM OF SECTION 1 CONSPIRACY

The Second Circuit, in holding that Discon had stated a valid claim of an agreement in violation of Section 1 of the Sherman Act, invoked the antitrust category of group boycott or (its equivalent) concerted refusal to deal. The court recognized that category to encompass the possibility of either a *per se* or a rule-of-reason standard, as this Court has expressly ruled (*Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co.*, 472 U.S. 284, 293, 297-98 & n.9 (1985)) and as the Second Circuit had recognized in previous decisions (*Balaklaw v. Lovell*, 14 F.3d 793, 800 (2d Cir. 1994); *Capital Imaging Assoc. v. Mohawk Valley Medical Assoc., Inc.*, 996

California, Inc. v. California State Council of Carpenters, 459 U.S. 519 (1983); *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978); *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1978); *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186 (1974).

F.2d 537, 543 (2d Cir.), *cert. denied*, 510 U.S. 947 (1993)).[14] In reinstating the challenge to the alleged NYNEX-AT&T agreement, the court of appeals accordingly held that the amended complaint was sufficient under one or the other standard, and it relied critically on the regulatory-evasion theory of the amended complaint in so holding. Pet. App. 10a-12a. The Second Circuit was wrong.

A. The Purely Vertical Agreement At Issue Is Not A Group Boycott

The alleged NYNEX-AT&T agreement is a purely vertical nonprice agreement between a purchaser and its supplier, as the Second Circuit acknowledged. *See* Pet. App. 10a & n.5. Nevertheless, the Second Circuit borrowed the category of group boycott, or concerted refusal to deal, from this Court's decision in *Klor's* and suggested that the category might "extend" to cover this agreement. Pet. App. 12a. That characterization is plainly incorrect. *Klor's*, as well as *United States v. General Motors Corp.*, 384 U.S. 127 (1966), and all of the other decisions of this Court falling into the familiar "group boycott" category of antitrust analysis, involved *horizontal* agreements, *i.e.*, agreements among competitors at the same level of distribution. *See Sharp*, 485 U.S. at 734 (*Klor's* and *General Motors* both "involved horizontal combinations"); ABA Section of Antitrust Law, *Antitrust Law Developments* 100-10 (4th ed. 1997).[15]

[14] *See Northwest Wholesale Stationers*, 472 U.S. at 293 (using "group boycott" and "concerted refusal to deal" interchangeably); *id.* at 297 (district court was "correct" in "recognizing that not all concerted refusals to deal should be accorded *per se* treatment"); *id.* at 297 n.9 (approving district court's application of "Rule of Reason" to "group boycott").

[15] *See, e.g., FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990); *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986); *Northwest Wholesale Stationers, supra; Klor's, supra; Northern*

It is thus a necessary condition for classification as a group boycott that a group of *competitors* be combining. In particular, they must be agreeing among themselves that they will not do business with—that they will boycott or, acting in concert, refuse to deal with—some other firm or firms. The essential precondition of a group boycott is a horizontal agreement. *See U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 594 (1st Cir. 1993) (Boudin, J.) ("a purely vertical arrangement, by which (for example) a supplier or dealer makes an agreement exclusively to supply or serve a manufacturer, is not a group boycott"); Pet. 10 n.4 (citing authorities from nine other circuits).

This precondition reflects basic antitrust policy. The reason a distinctive body of antitrust law has developed for such agreements is precisely that they involve "the aggregation of the power of several competitors—a reason that does not apply to distribution restraints involving a single manufacturer's product" or, indeed, to other vertical nonprice agreements. VIII P. Areeda, *Antitrust Law* ¶1644c, at 474 (1989) (footnote omitted); *see State Oil Co.*, 118 S. Ct. at 281 ("vertical restraints are generally more defensible than horizontal restraints"); *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 348 n.18 (1982). And, as this Court explicitly ruled in *Sharp*, the critical distinction between vertical and horizontal agreements cannot be erased by saying, as the Second Circuit did, that a vertical agreement might "be characterized as a horizontal restraint of trade" if it "seeks to disadvantage" one of the parties' competitors (Pet. App. 11a): such a mischaracterization confuses the *effects* of an agreement, which are inherently horizontal if they harm "competition," with the character of the agreement, which is intrinsically vertical if it is between a firm and

Pac. Ry. v. United States, 356 U.S. 1 (1958); *Fashion Originators' Guild v. FTC*, 312 U.S. 457 (1941); *Eastern States Retail Lumber Dealers' Ass'n v. United States*, 234 U.S. 600 (1914).

its supplier (or distributor). *Sharp*, 485 U.S. at 730 & n.4. The Second Circuit's invocation of the "group boycott" characterization for a vertical agreement thus was mistaken in both definitional and policy terms.

The court's mistake cannot be dismissed as an empty labeling problem. Businesses and their counsel broadly rely on established categories of antitrust doctrine to add clarity and predictability to their legal analyses of actual or contemplated marketplace conduct. Although doctrinal categories are not always neat and mutually exclusive, they define essential limits; instability and confusion are fostered, and businesses may be deterred from efficient conduct by the prospect of risky and costly treble-damages litigation, when courts breach those limits. In this case, the proper categorization dramatically changes the legal landscape. While a "group boycott" characterization would raise the uncertain prospect of *per se* analysis,[16] correctly characterizing the NYNEX-AT&T agreement as a *vertical* nonprice agreement makes clear that the agreement is subject to rule-of-reason standards, which Discon cannot meet, as explained below.

B. The Vertical Purchaser-Supplier Nonprice Agreement Here Can Be Challenged Only By Alleging And Proving Harm To Competition Under The Normal Rule Of Reason

The Second Circuit's reliance on *Klor's* allowed it to countenance the possibility of condemning the alleged

[16] The line separating group boycotts that are *per se* unlawful from those which are subject to the rule of reason has been acknowledged to be an uncertain one. *See Northwest Wholesale Stationers*, 472 U.S. at 294 ("there is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the *per se* doctrine") (internal quotation marks omitted); *see also FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. at 452-53 n.9 (Brennan, J., dissenting); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. at 543; ABA Section of Antitrust Law, *Antitrust Law Developments* 101-02 (4th ed. 1997).

NYNEX-AT&T agreement without requiring proper allegations and proof of harm to competition, *i.e.*, of market-wide curtailment of output and raising of price, through impairment of the process of competition by which actual or potential rivals offer alternatives to buyers. But such requirements are essential for any proper challenge to a purchaser-supplier agreement, even in the regulated-utility setting here.

1. *Per Se Analysis Does Not Apply*

"Ordinarily, whether particular concerted action violates § 1 of the Sherman Act is determined through case-by-case application of the so-called rule of reason—that is, 'the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.'" *Sharp*, 485 U.S. at 723 (quoting *GTE Sylvania*, 433 U.S. at 49); *see State Oil Co.*, 118 S. Ct. at 279. Certain types of agreement, however, "have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful *per se*." *State Oil Co.*, 118 S. Ct. at 279. Such exceptions to the usual requirements of alleging and proving anticompetitive effects have been adopted with "reluctance" (*id.*) and only when experience has shown that the particular type of agreement is "manifestly anticompetitive" because it "would always or almost always tend to restrict competition and decrease output." *Sharp*, 485 U.S. at 723-24 (internal citations and quotation marks omitted).

No *per se* standard can be applied in this case. This Court has squarely rejected the application of a *per se* standard to vertical nonprice agreements. In *GTE Sylvania*, the Court overruled *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), "thereby rejecting application of a *per se* rule in the context of vertical non-

price restrictions." *State Oil Co.*, 118 S. Ct. at 281; *see* U.S. Br. at 15, in *State Oil Co.* (under *GTE Sylvania*, "vertical non-price restraints should be judged under the rule of reason"). Subsequently, the Court not only has reiterated the requirement of rule-of-reason analysis for vertical nonprice agreements (*Sharp, supra*; *State Oil Co., supra*), but has insisted on its importance: the Court has "been solicitous to assure that the market-freeing effect of [its] decision in *GTE Sylvania* is not frustrated by related legal rules." *Sharp*, 485 U.S. at 726. *See id.* ("rules in this area should be formulated with a view towards protecting the doctrine of *GTE Sylvania*").

The reason for protecting vertical nonprice agreements against treble-damages liability in the absence of proven market harm fully applies to the agreement at issue. Even if the alleged NYNEX-AT&T agreement committed NYNEX to exclusive purchases of removal services from AT&T—which it is not alleged to do (*see* page 5, *supra*) —it would be a type of agreement that has long been recognized to serve legitimate, procompetitive objectives. Exclusive dealing arrangements often provide the buyer assurance of supply, stability of price, and savings of transaction costs, while enabling the supplier to make reliable plans for building, acquiring, or using physical resources as well as hiring employees. Such agreements, therefore, have long been protected against liability in the absence of proof of harm to competition. *See, e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 29-31 (1984); *id.* at 46 (O'Connor, J., concurring); *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 334 (1961); *Standard Oil Co. v. United States*, 337 U.S. 293, 306-07 (1949); *U.S. Healthcare, Inc.*, 986 F.2d at 595; *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236-37 (1st Cir. 1983); *see* SG Pet. Br. 14 n.11 ("such agreements are considered to enhance efficiency"). The Second Circuit itself recognized that "[i]n the vast majority of cases, the decision to discriminate in favor of

one supplier over another will have a pro-competitive intent and effect." Pet. App. 12a. Accordingly, treble-damages liability for a vertical nonprice agreement like the alleged NYNEX-AT&T agreement cannot be imposed without the proof of harm to competition required by the rule of reason. *See Jefferson Parish*, 466 U.S. at 31 ("Without a showing of actual adverse effect on competition, [a plaintiff challenging an exclusive dealing arrangement] cannot make out a case under the antitrust laws . . . .").

2. *The Rule Of Reason, Requiring Allegations And Proof Of Harm To Competition, Applies*

This requirement is not met simply because an individual competitor has been harmed. The very meaning of this Court's repeated insistence that the Sherman Act protects "*competition*, not *competitors*" (*Brown Shoe Co.*, 370 U.S. at 320; *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977); *Brooke Group*, 509 U.S. at 224) is that an agreement, to be condemned as anticompetitive, must make purchasers in the market worse off by significantly limiting the overall range of existing as well as potential sellers, or their ability to compete, so as to subject purchasers to reduced output and raised price. In the absence of such a marketwide contraction, purchasers can turn to alternatives, whether existing sellers or new entrants, and any harm is only to competitors, not competition. *See Tampa Electric*, 365 U.S. at 327 (foreclosure of "competition" under Section 3 of the Clayton Act, 15 U.S.C. § 14, requires marketwide inquiry); *id.* at 335 (applying result to Section 1 of the Sherman Act).[17]

[17] This point is often formulated as a requirement of proof of actual or threatened market power to satisfy the anticompetitive effects test for a rule-of-reason violation. *See Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756, 761 (7th Cir. 1997); *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 965-66 (10th Cir. 1994), *cert. denied*, 515 U.S. 1152 (1995); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 229 n.11, 230 (D.C. Cir. 1986) (Bork, J.), *cert. denied*, 479 U.S. 1033 (1987); *Ball Memorial Hospital, Inc. v. Mutual Hospital Ins., Inc.*, 784 F.2d 1325, 1334-35 (7th Cir. 1986); *see also Apex Hosiery Co. v. Leader*, 310 U.S. 469, 512 (1940) (no antitrust liability for agreements that "fall short, both in their purpose and effect, of any form of market control of a commodity").

Thus, a Section 1 plaintiff challenging a purchaser-supplier nonprice agreement must prove—and, at the complaint stage, must make allegations from which reasonable inferences may be drawn—that the agreement has harmed or will harm marketwide competition to the detriment of the buyers in that market.

These preconditions for pursuing a Section 1 claim are especially important when firms change suppliers. Freedom to make such changes is the critical procompetitive mechanism by which the free market economy induces sellers to reduce their costs and improve their quality to win customers in competition with rivals, yet the termination of a supplier presents a predictable invitation for burdensome treble-damages litigation, or threats of such litigation, by a supplier wanting to make its purchaser pay a litigation price for choosing to change. Preserving the requirement of harm to competition—with appropriate insistence on specificity at the complaint stage to ensure that the heavy burdens of further proceedings are themselves adequately justified—is critical for protecting the leeway of businesses to make competitively vital decisions to change suppliers.

Accordingly, the competitive importance of freedom to replace suppliers, like the competitive importance of freedom to replace distributors, has been recognized in the large number of judicial decisions rejecting claims by disappointed suppliers under the same standard applied to terminated distributors: "a complaint which simply alleges that a manufacturer substituted one distributor for another fails to state a violation of the rule of reason, *unless* it also alleges anticompetitive effect at the interbrand

level."[18] That body of judicial experience reflects this Court's repeated insistence on "protecting the doctrine of *GTE Sylvania*." *Sharp*, 485 U.S. at 726; *see Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763-64 (1984). Any relaxation of the requirements that the plaintiff fully bear the burden of alleging and proving marketwide harm in this context would threaten the very result condemned by this Court in *Sharp*: "Manufacturers would be likely to forgo legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties." 485 U.S. at 728.[19]

At the petition stage, the Government read the Second Circuit opinion as relaxing the plaintiff's requirements and instead shifting to the defendants some burden to produce and defend a "valid procompetitive justification" for the

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[18] *Crane & Shovel Sales Corp. v. Bucyrus-Erie Co.*, 854 F.2d 802, 806 (6th Cir. 1988); *see, e.g., Coastal Transfer Co. v. Toyota Motor Sales, U.S.A.*, 833 F.2d 208, 211 (9th Cir. 1987) ("recurrent case of the jilted . . . supplier who loses a manufacturer's franchise and accuses the manufacturer and the new suitor of attempting to monopolize something"); *Rutman Wine Co. v. E. & J. Gallo Winery*, 829 F.2d 729, 735 (9th Cir. 1987); *Great Escape, Inc. v. Union City Body Co.*, 791 F.2d 532, 539 (7th Cir. 1986); *Dunn & Mavis, Inc. v. Nu-Car Driveaway, Inc.*, 691 F.2d 241, 245 (6th Cir. 1982); *A.H. Cox & Co. v. Star Machinery Co.*, 653 F.2d 1302, 1306 (9th Cir. 1981) (Kennedy, J.); *Burdett Sound, Inc. v. Altec Corp.*, 515 F.2d 1245, 1249 (5th Cir. 1975).

[19] Because freedom to change suppliers is so vital to a competitive economy, the harmful effect of lowering the threshold for extensive and uncertain antitrust suits by disappointed suppliers is akin to that of weakening the standards for challenging pricing behavior—as to which the Court has noted: "[M]istaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect. '[W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.'" *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (citation to *Monsanto* omitted; quoting *Barry Wright*, 724 F.2d at 234).

challenged vertical nonprice agreement. SG Pet. Br. 12-13, 16-17. But any such standard, by forcing businesses to justify their choices to government enforcers and courts in the absence of present or threatened marketwide harm, would substantially increase litigation costs and thus have the very adverse effect on market freedom that this Court and lower courts have strived to prevent. Not surprisingly, then, the suggestion violates well-established black-letter law: "The plaintiff bears the burden of proving that a restraint has a substantial anticompetitive effect. Absent such an anticompetitive effect, the defendant need not proffer justifications for its conduct." ABA Section of Antitrust Law, *Antitrust Law Developments* 55 (4th ed. 1997) (footnotes citing decisions omitted).

No precedent supports watering down the fundamental rule-of-reason requirement of alleging and proving market harm to challenge a vertical nonprice agreement. The two decisions cited by the Government provide no such support. *See* SG Pet. Br. 16 (citing *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), and *NCAA v. Board of Regents*, 468 U.S. 85 (1984)). Both involved *horizontal* agreements—one between colleges competing to attract television money for their sporting events (*NCAA*), the other between dentists competing for the dollars paid by patients and their insurance carriers (*Indiana Federation*)—that directly limited the parties' competition with one another on important price or service terms. Even for such a horizontal agreement, which the Court in *NCAA* described as involving a "naked restraint on price and output" (468 U.S. at 110) that might have been condemned as *per se* unlawful in the absence of special factors (the sports and professional-association contexts), the Court did not dispense with the requirement of market harm. Instead, it concluded that the requirement was satisfied without "elaborate market analysis" (*Indiana Federation*, 476 U.S. at 461) based on the factfinder's findings of

" 'actual detrimental effects, such as reduction of output.' " *Id.* at 460; *NCAA*, 468 U.S. at 109-10.[20]

Thus, even for horizontal agreements not covered by *per se* rules, this Court's decisions require plaintiffs to allege and prove market harm.[21] But whatever may ultimately be determined for certain horizontal agreements, no weakening of plaintiffs' proof requirements could apply to vertical nonprice agreements after *GTE Sylvania* and *Sharp*. *See U.S. Healthcare, Inc.*, 986 F.2d at 594-95 (rejecting "quick look" analysis of vertical exclusive dealing arrangements). No such approach could be squared with this Court's insistence on maintaining the line between horizontal and vertical agreements with clarity so as to preserve firms' important freedom to choose, to change, and to enter into exclusive-dealing and similar contracts with suppliers. *See Sharp*, 485 U.S. at 726, 730 & n.4. Proper allegation and proof of marketwide harm must remain a precondition to a Section 1 challenge to a vertical nonprice agreement.

3. *The Regulated Setting Does Not Weaken The Requirements*

The regulated monopoly setting alleged in the present case provides no justification for weakening the basic rule-

[20] In *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978), the Court noted that "no elaborate industry analysis is required to demonstrate the anticompetitive character" of an agreement among 69,000 engineers nationwide to refuse to discuss price with customers until after selection of the engineer. Not surprisingly, this point was not in dispute before this Court, which instead was presented with the issue whether the agreement could be justified by considerations of safety and professional ethics.

[21] Even in the horizontal context, the suggestion of a "quick look" or "stepwise" approach, shifting a burden of justification to the private parties to an agreement that is not unlawful *per se*, has been criticized. *See* Kolasky, "The Department of Justice's 'Stepwise' Approach Imposes Too Heavy a Burden on Parties to Horizontal Agreements," *Antitrust* at 41 (Spring 1998).

of-reason requirements for challenging such purchaser-supplier contracts. Regulated companies (or, more generally, businesses operating under cost-plus contracts) are no less in need of the freedom to make efficient changes of suppliers, or to enter into efficiency-enhancing requirements contracts, than are other companies. That freedom, and its procompetitive benefits, would be threatened by diluting the critical requirement of market harm for a disappointed supplier to maintain a Section 1 challenge. As the Government recognized at the petition stage, "[v]irtually any requirements contract could be characterized as a 'two-firm vertical' agreement 'to discriminate in favor of one supplier over another.' " SG Pet. Br. 14 n.11 (quoting Pet. App. 12a).

Indeed, the regulated utility setting alleged here provides, if anything, particular reasons to strengthen, not weaken, the pleading and proof requirements. With regulators monitoring the very sort of conduct alleged in the amended complaint (*see* Pet. App. 5a; note 7, *supra*), "strict antitrust scrutiny is less likely to be necessary." *Kartell v. Blue Shield of Massachusetts, Inc.*, 749 F.2d 922, 931 (1st Cir. 1984), *cert. denied*, 471 U.S. 1029 (1985). At the same time, under Discon's premise of pass-through of excess costs to captive telephone ratepayers, downstream consumers could less easily avoid the predictable increase in supplier costs that the threat of burdensome antitrust litigation would impose on a regulated firm like NYNEX. It is perverse to deter efficient input choices precisely where the adverse impact on consumers, under Discon's theory, would be least escapable.

C. The Allegations Of Fraudulent Overcharging Of Telephone Ratepayers Do Not State A Competitive Harm

In invoking group-boycott doctrine and suggesting *per se* condemnation, the Second Circuit relied on the claim

of regulatory evasion as itself establishing competitive harm. That reliance fundamentally confused the purported harm to ratepayers in the regulated telephone-service market, which is only a regulatory problem, with the required harm to competition in the alleged markets for removal services, the only markets where competition is even claimed to be restrained. The ruling rests on two important errors.

1. The Second Circuit violated the elementary requirement that relevant markets be defined. The effect on "competition, not competitors," cannot be assessed without specifying the relevant markets, which determine the range of existing and potential rivals available to purchasers. *See Tampa Electric*, 365 U.S. at 327, 329 ("the threatened foreclosure of competition must be in relation to the market affected"; "the relevant market is the prime factor in relation to which the ultimate question, whether the contract forecloses competition in a substantial share of the line of commerce involved, must be decided"); *see Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993) (" '[w]ithout a definition of [the relevant] market there is no way to measure [the defendant's] ability to lessen or destroy competition' "); *GTE Sylvania*, 433 U.S. at 53 n.21 ("an antitrust policy divorced from market considerations would lack any objective benchmarks").[22] Accordingly, it is well settled that " '[w]ithout defining the relevant market, there is no meaningful context within which to assess the restraint's com-

[22] Contrary to the Government's suggestion at the petition stage, *Jefferson Parish* did not repudiate the need for careful attention to the market where competition is allegedly restrained. *See* SG Pet. Br. 9 (describing *Jefferson Parish*, 466 U.S. at 29-30, as recognizing the availability of liability for a "restraint in one market that causes anticompetitive effects in another market"). The cited passage indicates nothing more remarkable than that absolute precision in defining the exact contours of the relevant market may not be needed where the challenged agreement could not be found to constrain overall market competition under any of the possible market definitions. 466 U.S. at 29-31.

petitive effects." ABA Section of Antitrust Law, *Antitrust Law Developments* 59 (4th ed. 1997) (citing *Copperweld*, 467 U.S. at 768; *Arnold, Schwinn & Co.*, 388 U.S. at 381-82; *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594, 615 (1953); *United States v. Columbia Steel Co.*, 334 U.S. 495, 519 (1948)); *see DeVoto v. Pacific Fidelity Life Insurance Co.*, 618 F.2d 1340, 1345 (9th Cir. 1980) (Kennedy, J.) ("Absent per se violation, competitive injuries must be defined in terms of a discrete market.").[23] By ignoring this principle, the Second Circuit failed even to ask whether *competition* was harmed in any market here, let alone in the alleged markets.

2. That failure in turn led the court to misidentify the alleged problem in the telephone-service market as a competitive problem. Wrongs such as fraud, whether directed to consumers or rivals, do not constitute an antitrust violation in the absence of proof of the required adverse effect on market competition. This Court often has recognized that the antitrust laws, which supplemented (and did not subsume) the preexisting and distinct bodies of law on fraud and unfair competition (and even common-carrier regulation), "do not create a federal law of unfair competition or 'purport to afford remedies for all torts committed by or against persons engaged in interstate commerce.' " *Brooke Group*, 509 U.S. at 225 (quoting *Hunt v. Crumboch*, 325 U.S. 821, 826 (1945)); *see City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 378-79

[23] Inattention to the relevant market undermines the assessment not only of any claims of harm to competition but also of antitrust standing and injury. For example, except for its now-dismissed claim as a ratepayer, Discon's only relationship to the market for telephone services was not as a consumer or competitor, but as a supplier to the sellers. Suppliers in that position have generally been barred from suing. *See SAS of Puerto Rico, Inc. v. Puerto Rico Telephone Co.*, 48 F.3d 39, 42, 44 (1st Cir. 1995) (citing II P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 375 (rev. ed. 1995)); *see also Associated General Contractors*, 459 U.S. at 539.

(1991) (antitrust laws do not provide remedy for political corruption); *Apex Hosiery*, 310 U.S. at 512 ("the Sherman Act was not enacted . . . to afford a remedy for wrongs, which are actionable under state law, and result from combinations and conspiracies which fall short, both in their purpose and effect, of any form of market control of a commodity"); *see Sitkin Smelting & Ref. Co. v. FMC Corp.*, 575 F.2d 440, 448 (3d Cir.) ("the Sherman Act may not be extended beyond its intended scope and used to police the morals of the marketplace"), *cert. denied*, 439 U.S. 866 (1978). The Second Circuit's reliance on regulatory evasion in this case disregards that principle: it transforms into an antitrust problem what is at most an alleged fraud on regulators acting as a surrogate for consumers under a distinct body of law.

At the petition stage, the Government elaborated the Second Circuit's reliance on the alleged regulatory evasion as causing anticompetitive effects into a full-fledged theory of antitrust liability. SG Pet. Br. 7-12. According to the Government: "[a]n agreement between a regulated monopolist and its supplier to exclude a competing supplier from the market, when that agreement has the purpose and effect of enabling the monopolist to evade regulatory scrutiny and exercise market power in a downstream market, violates Section 1 in the absence of any procompetitive justification." *Id.* at 12. By its terms, this standard dispenses with any requirement of harm to competition in the market from which the supplier was allegedly excluded. The Government's striking proposal, like the Second Circuit reference it elaborates, is insupportable.

To begin with, the amended complaint does not identify any telephone-service market (where NYNEX sold service) as a relevant market in which competition was restrained. Rather, the only relevant markets in which competition was allegedly restrained are two markets for removal services sold by Discon—one where NYNEX

was the sole buyer ("at NYT") and the other where NYNEX was the dominant buyer ("in the New York State area"). *See* pages 3-4, *supra*. That definition of the relevant markets reflects the simple fact that the alleged regulatory-evasion scheme had nothing to do with keeping out any rival sellers of telephone service.

More importantly, the theory that mere overcharges in the regulated telephone-service market are legally sufficient to constitute anticompetitive effects supporting antitrust liability is deeply and perilously wrong. The theory rests squarely on the premise that "[a]n increase in consumer prices resulting from the exercise of market power is an anticompetitive effect." SG Pet. Br. 8; *id.* at 9 n.6 ("[t]he anticompetitive effect . . . is the *exercise* of market power"). This premise embodies a fundamental logical mistake. It starts with this Court's insistence on harm to competition, not merely competitors; it properly understands that harm to competition requires consumer exploitation through reduction of output and raising of price; but it then mistakenly transforms that concept from a *necessary* condition into a *sufficient* condition, thus bringing all reductions of output and raising of price into antitrust's fold. But while harm to competitors is not enough to constitute harm to competition, it is a precondition. The contrary assertion is a radical and deeply misconceived effort to extend antitrust law, which is concerned only with consumer harms brought about *through diminished competition*, to other forms of alleged consumer exploitation, such as fraud and regulatory evasion, that have nothing to do with impaired competition.

This Court has made clear that "the sole aim of antitrust legislation is to protect competition." *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659, 689 (1975). The Sherman Act addresses only harms to "competitive conditions." *National Society of Professional Engineers*, 435 U.S. at 688, 690. The Act thus targets only "actions that harm the competitive process." *Clamp-All*

Corp. v. Cast Iron Soil Pipe Institute, 851 F.2d 478, 486 (1st Cir. 1988), *cert. denied*, 488 U.S. 1007 (1989); *Interface Group, Inc. v. Massachusetts Port Authority*, 816 F.2d 9, 10 (1st Cir. 1987). In this crucial respect, "the antitrust laws differ from classical regulation both in their aims and in their methods," for, unlike direct regulation, they "seek to create or maintain the *conditions* of a competitive marketplace rather than replicate the *results* of competition or correct for the defects of competitive markets." S. Breyer, *Regulation and Its Reform* 156-57 (1982); *see also Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991).

Given the focus of antitrust policy on the opportunities of rivals, numerous courts have recognized that the exercise of market power is *not* anticompetitive. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 294 (2d Cir. 1979) ("[s]etting a high price may be a use of monopoly power, but *it is not in itself anticompetitive*") (emphasis added), *cert. denied*, 444 U.S. 1093 (1980).[24] Over-

[24] *See Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic*, 65 F.3d 1406, 1412-13 (7th Cir. 1995) (Posner, C.J.) ("[T]he antitrust laws do not regulate the prices of natural monopolists. A natural monopolist that acquired and maintained its monopoly without excluding competitors by improper means . . . can therefore charge any price that it wants, for the antitrust laws are not a price-control statute or a public-utility or common-carrier rate-regulation statute.") (citations omitted), *cert. denied*, 116 S. Ct. 1288 (1996); *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 548-49 (9th Cir. 1991) (same point as *Berkey*), *cert. denied*, 503 U.S. 977 (1992); *Williamsburg Wax Museum, Inc. v. Historic Figures, Inc.*, 810 F.2d 243, 252 (D.C. Cir. 1987) ("imposition of a high price is not, in and of itself, an anticompetitive act"); *Kartell*, 749 F.2d at 927 ("Ordinarily, however, even a monopolist is free to exploit whatever market power it may possess when that exploitation takes the form of charging uncompetitive prices."); *Trace X Chem., Inc. v. Canadian Indus., Ltd.*, 738 F.2d 261, 268 (8th Cir. 1984) ("[S]etting a high price is not in itself anti-competitive."), *cert. denied*, 469 U.S. 1160 (1985).

charging consumers by exercising market power may present a regulatory problem, but it is not an antitrust problem absent impairment of rivals' opportunities. To the contrary, "the charging of a high price is, so far as potential competitors are concerned, an attracting rather than an excluding practice." *Marshfield Clinic*, 65 F.3d at 1413; *see Berkey*, 603 F.2d at 294. *See* III P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 720a, at 206 (rev. ed. 1996) ("[A] monopolist does not impair the opportunities of rivals or otherwise exclude competition by charging a monopoly price. On the contrary, high prices encourage the entry and expansion of rivals."); *id.* ¶ 720b, at 208 ("The goal of antitrust should always be to encourage *competition*, not the indefinite perpetuation of price-regulated monopoly.").

The Government itself previously recognized that antitrust law reaches evasion of rate regulation only where competition in an unregulated market is harmed. The Government told the D.C. Circuit in the Bell System litigation that regulatory evasion through cost-shifting from a competitive market to a regulated one is not a *competitive* concern unless it also results in the threat of market power in the unregulated market: it sharply distinguished regulatory evasion "that does not afford any possibility of creating market power and that raises no competitive concern" from regulatory evasion that leads to "market power in the unregulated market" and thus raises antitrust concerns.[25] That position, rather than the

[25] "Avoiding such overcharges to ratepayers in the regulated monopoly market is a regulatory concern. Under some circumstances, cross-subsidization through cost misallocation can also be a competitive concern because a firm that can recover some of the costs of its competitive operations in the rate-regulated monopoly market by including those costs in the rate base can price below cost in the competitive market without losing money. If as a result of this cross-subsidization the monopolist succeeds in driving out its competitors and preventing new entry, it may be in a position to

Government's new position, accords with the analysis of the leading commentary. *See* IIIA P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 787b, at 284-85 (1996) (antitrust law is implicated by regulated firm's activity in related market only when "the conduct really threatens the competitive vigor of a vertically or collaterally related market"; "fact that the utility is transferring monopoly profits from regulated electricity to unregulated coal [through regulatory evasion] presents no antitrust issues but simply those of appropriate regulatory review of a firm's rates"—unless conduct "effectively forecloses a large, otherwise competitive market"); *id.* ¶ 787c1, at 294 (when utility engages in rate-regulation avoidance, "antitrust is not concerned with rates as such," but "it becomes concerned when the utility's attempt to enlarge profits eliminates competition in a collateral market capable of being competitive").

Simple practical reasons underscore the importance of continuing to respect the dividing line between regulatory problems and antitrust problems. Under the Government's theory, any change of supplier by a regulated monopolist (or, perhaps, any cost-plus business), at least any change to a superficially more costly supplier, could give rise to a Section 1 claim by the displaced supplier, requiring the regulated firm to establish a procompetitive justification in costly litigation over intent and effect, thus deterring efficient changes of supplier. If suppliers could sue based on harm connected to overcharges, many of the numerous other complaints of regulatory violations made each year might also give rise to antitrust cases. Judges and juries would become embroiled in making decisions about complex and evolving regulatory accounting and pricing issues —and perhaps become entangled with regulatory agencies

raise its prices to the detriment of consumers in the unregulated market." U.S. Br. 29, *United States v. Western Elec. Co.*, No. 87-5388 (D.C. Cir. Apr. 17, 1989).

themselves, whether through attempting to coordinate with them or through simple second-guessing of key regulatory determinations—in unfamiliar, unnecessary, and inappropriate ways. *Cf. Town of Concord*, 915 F.2d at 25-29; *Kartell*, 749 F.3d at 927. However unavoidable such inquiries might be in some circumstances, this Court should reject the proposed distortion of antitrust law that would invite such difficulties here, as it rejected the Government's related attempt to blur the line between antitrust law and another regulatory regime in *Brown v. Pro Football, Inc.*, 518 U.S. 231, 236-37 (1996).[26] *See* III P. Areeda, *Antitrust Law* ¶ 720b, at 207-08 (rev. ed. 1996) (antitrust courts have avoided price regulation because "judicial tribunals lack both the expertise and the narrow jurisdictional focus necessary to make such regulatory schemes work"); IX P. Areeda, *Antitrust Law* ¶ 1712d, at 142 (1991) (Antitrust tribunals "are no better able than the regulatory authorities to examine a particular evasion. If the regulators choose not to reach it, they have introduced some indirect flexibility in their regime. If they cannot reach it, then the underlying legislation or appropriations has created such flexibility, perhaps consciously as wise public policy or as a political compromise in the enactment.").

The effort to extend antitrust law to cover regulatory evasions without anticompetitive effects is not supported by *Jefferson Parish*, the Government's only cited authority. The majority in that case and the four Justices in concurrence both observed that regulatory evasion may explain why certain tying arrangements are undertaken

[26] "We recognize, as the Government suggests, that, in principle, antitrust courts might themselves try to evaluate particular kinds of employer understandings, finding them 'reasonable' (hence lawful) where justified by collective-bargaining necessity. But any such evaluation means a web of detailed rules spun by many different nonexpert antitrust judges and juries, not a set of labor rules enforced by a single expert administrative body, namely, the [National Labor Relations] Board." 518 U.S. at 236-37.

(466 U.S. at 13 n.19, 36 n.4), but neither opinion says that the exercise of lawfully possessed market power is an "anticompetitive" effect in the absence of impairment of rivals' opportunities to compete in the market allegedly restrained. *See* IX P. Areeda, *Antitrust Law* ¶ 1712d, at 143 (1991) (discussing references to regulatory evasion in *Jefferson Parish*, explaining that the courts have not treated and should not treat "evasion of state or federal maximum price control" as counting "for or against ties, either generally or in particular cases"). Moreover, the decision cannot imply any such holding, because the case unmistakably involved alleged consumer harm *through impaired competition* (for anesthesiology services and for doctor-hospital affiliations).

In sum, transforming regulatory evasion into a Section 1 theory based on harm in the telephone-service market indefensibly and dangerously confuses a regulatory problem with an antitrust problem. The leading commentary makes this point, criticizing the Second Circuit decision for "effectively turn[ing] a claim of fraud into an antitrust claim. For example, any seller under a cost-plus contract might secretly conspire with a supplier to provide goods at inflated costs, paying a secret rebate to the seller, and with the effect of excluding alternative suppliers. As in any case of fraud or misrepresentation, the result will be that the contracted-for good is more costly and consumers are injured. But no antitrust violation is apparent unless this activity threatens monopoly in a properly defined relevant market." P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 1644'c, at 727 (Supp. 1997). Competitive analysis thus must focus not on telephone-service markets but only on the alleged markets for removal services.

D. Harm To Competition In The Removal-Services Markets Is Not Adequately Alleged

As confirmed by the Second Circuit's and Government's resort to novel efforts to transform regulatory evasion into

an antitrust problem, the amended complaint does not adequately allege harm to competition, as opposed to harm to Discon itself, in the removal-services markets actually alleged in the amended complaint. Discon has claimed that it was injured by the alleged NYNEX-AT&T agreement to exclude it from being a supplier to NYNEX, although that single buyer's change of supplier did nothing to prevent Discon from serving other available buyers of removal services. But even under Discon's artificial market definitions (removal services "at NYT" and "in the New York State area"), this alleged harm to an individual competitor does not constitute harm to competition, *i.e.*, a marketwide limitation on the ability of existing and potential suppliers of removal services to offer lower prices or better service to meet consumer demand in competition with AT&T and other providers of removal services. The amended complaint simply lacks the essential additional allegations of such market harm that should be required before allowing extensive litigation to proceed.

The amended complaint does not allege that other competitors in the removal-services markets were excluded, that purchasers as a whole in those markets were deprived of existing or easily available alternatives, or that any significant entry barriers existed to impede new firms from coming into the market to correct any shortage of output or raising of price. *See* SG Pet. Br. 9 n.8. These omissions are critical as a substantive matter; they cannot be excused as a matter of mere insufficient detail. Discon's amended complaint and original complaint show that other present and potential suppliers of removal services did exist (J.A. 111 (Am. Compl. ¶ 107)); that telephone companies can serve their removal-services needs simply by using their own employees to do this work (J.A. 83 (Am. Compl. ¶ 27)); and that entry into this business of dismantling and disposing of telephone central office equipment, far from requiring substantial sunk costs or other up-front investments, is extremely easy: Discon

immediately won a $500,000 contract and had 25 employees (with plans to triple that number) within six months (J.A. 15, 17 (Compl. ¶¶ 50, 52, 61)); J.A. 87 (Am. Compl. ¶ 40)). With such facts conceded, the omissions from the amended complaint of key allegations needed to imply marketwide harm are critical.

The determinative character of what is missing from the amended complaint is properly judged in light of the nature of the scheme alleged. For the alleged NYNEX-AT&T agreement to produce marketwide harm in the alleged removal-services markets, NYNEX would have to be agreeing to subject itself to exploitation through higher prices set by removal-services sellers in an output-constricted (and entry-protected) market. Such a claim is inconsistent with Discon's concessions about NYNEX's ability to use its own employees to remove equipment and about ease of entry into the business, as well as with Discon's allegation that NYNEX itself "effectively controlled the price at which contracts for removal services were obtained." J.A. 111 (Am. Compl. ¶ 104).

Equally important, such a claim is unsupported by the basic theory of Discon's case. The alleged profit-making mechanism of regulatory evasion in no way depended on or implied any reduction in NYNEX's own purchases of removal services, let alone a contraction of supply or raising of price of removal services marketwide. That alleged scheme produced its alleged benefits for NYNEX without any impairment of NYNEX's retention of full ability to buy removal services at competitive prices whenever it wished, whether from existing suppliers, readily available new entrants, or its own employees. Indeed, it is simply not rational economic behavior for a buyer like NYNEX to agree to create market conditions—a shortage of suppliers protected by entry barriers—in which it could then be exploited. *See Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1109, 1110 (7th Cir. 1984) (dismissing complaint, explaining that theory of buyer's agreement to give seller market power to exploit it is "inherently implausible," even "preposterous"), *cert. denied*, 470 U.S. 1054 (1985); *Adaptive Power Solutions, LLC v. Hughes Missile Systems Co.*, 1998 WL 172774, at *5-*6 (9th Cir. Apr. 15, 1998) (lack of "economic sense" of similar claim supports summary judgment); *Coastal Transfer*, 833 F.2d at 211 ("illogical" nature of similar claim supports summary judgment); *TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1026-27 (10th Cir) (dismissing similar claim of Section 2 conspiracy as "implausible"), *cert. denied*, 506 U.S. 999 (1992).

This is precisely the type of situation where, as this Court held in *Associated General Contractors*, 459 U.S. at 526, 528 n.17, an amended complaint is properly dismissed, and extensive litigation avoided, for lack of essential specificity. In the summary judgment context, this Court has barred antitrust claims that are "implausible" and "make[] no economic sense." *Matsushita*, 475 U.S. at 587. While the present case involves a motion to dismiss under Rule 12(b)(6), the required judgment whether an amended complaint is specific enough can be made only in light of the inherent economic plausibility of the plaintiff's theory of antitrust harm. In particular, given the serious burdens of litigating an antitrust case even to the summary-judgment stage, disregarding the omission of essential allegations so as to authorize proceeding on an economically implausible complaint would undermine the policy of protecting the important leeway for vertical non-price agreements recognized in *GTE Sylvania*, *Monsanto*, and *Sharp*. The amended complaint was properly dismissed by the district court.

II. THE AMENDED COMPLAINT DOES NOT STATE A VALID CLAIM OF SECTION 2 CONSPIRACY

Discon's Section 2 conspiracy-to-monopolize claim is a concerted-action Section 1 claim in a different guise. The Second Circuit's revival of this claim produces the same

practical litigation risks and burdens for vertical nonprice agreements involving changes of supplier, and thus the same economically harmful effects, as the revival of the Section 1 claim. For the same and additional reasons, the Section 2 conspiracy claim is as defective as the Section 1 claim.

1. Dismissal of the Section 2 conspiracy claim follows *a fortiori* from dismissal of the Section 1 conspiracy claim. Explaining the fact that this "curious" part of Section 2 has been so little used since its enactment one hundred years ago, but instead typically has been treated as "no more than an afterthought appended to § 1 claims," the leading commentary has observed that "[a]ny arrangement that could be considered a 'conspiracy' to monopolize must necessarily also be an unreasonable 'contract,' 'combination,' or 'conspiracy' in restraint of trade." IIIA P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 809, at 370-371 (1996); *see also* R. Posner, *Antitrust Law: An Economic Perspective* 216 (1978). At least in a private lawsuit necessarily complaining of antitrust injury, a Section 2 conspiracy must be a subcategory of a conspiracy to restrain trade.[27] The full argument made above for why the Section 1 conspiracy claim cannot survive, therefore, is also made for and *a fortiori* defeats the Section 2 conspiracy claim. If, as argued above, there is no actionable conspiracy to restrain trade, there cannot be a conspiracy to monopolize.

2. The only basis on which the Second Circuit revived Discon's Section 2 conspiracy claim was its characterization of the claim as alleging that NYNEX conspired to

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[27] Because this is a private suit requiring proof of antitrust injury, the Court need not consider here whether, for example, a conspiracy to monopolize might be proscribed in a criminal proceeding where there is no actual or threatened effect on competition in any market, but a pure intentional agreement to monopolize without any probability of success.

give *AT&T* monopoly power over removal services. Pet. App. 15a. But "[t]he Complaint, fairly read, does not include such [a] claim[]." *Ohio Forestry Ass'n, Inc. v. Sierra Club*, No. 97-16 (May 18, 1998), slip op. 11. First, the Section 2 conspiracy count parallels the immediately preceding Section 2 monopolization and attempted-monopolization counts, both of which allege that the actual or putative monopolist in the removal-services markets was NYNEX, not AT&T. *See* J.A. 110-12 (Am. Compl. ¶¶ 100, 104, 107). Second, Discon unmistakably told the Second Circuit that its Section 2 conspiracy allegation was that the conspiracy was to make NYNEX the monopolist. *See* note 12, *supra*. Third, the Second Circuit's recharacterization of the Section 2 conspiracy claim results in an economically senseless theory: that NYNEX, along with several non-AT&T providers of removal services, conspired to give AT&T monopoly power in removal-services markets where NYNEX would then be subject to exploitation as a buyer. *See* pages 38-39, *supra*. In these circumstances, the Second Circuit's *sua sponte* replacement of Discon's legally incorrect theory about NYNEX as a putative monopolist with an unpleaded and economically implausible theory about AT&T as the putative monopolist was improper. *Cf. Trest v. Cain*, 118 S. Ct. 478, 481 (1997) (noting dangers of springing such surprises on the parties).

Thus, the only Section 2 conspiracy claim that Discon can fairly be said to have made is that a monopoly by NYNEX was the object of the conspiracy. That claim, however, was subject to dismissal for the same reason the Second Circuit upheld dismissal of the claims of monopolization and attempted monopolization. NYNEX could never be a monopolist in a market where it was not, and had no plans to become, a seller at all. *See* Pet. App. 13a-14a.

3. The Second Circuit's theory, even aside from the fact that it cannot fairly be read into Discon's amended

complaint, is inadequate to sustain the Section 2 conspiracy claim. The Second Circuit recognized, as this Court has indicated and the lower courts have repeatedly held, that a Section 2 conspiracy requires that the parties conspire with the specific intent to monopolize. *See* Pet. App. 14a; *American Tobacco Co. v. United States*, 328 U.S. 781, 788-89, 809 (1946); ABA Section of Antitrust Law, *Antitrust Law Developments* 302 (4th ed. 1997). The sufficiency of Discon's conspiracy allegations under Section 2 should be judged in the light of the same protective policy against inferring conspiracies in the Section 1 context (*see Sharp, supra*; *Matsushita, supra*; *Monsanto, supra*), for the dangers that efficient marketplace conduct will be deterred by burdensome litigation are comparable.

Here, the bare-bones allegation of a conspiracy with the specific intent to monopolize should not suffice to launch extensive litigation, for much the same reasons the amended complaint does not suffice to allege marketwide harm under Section 1. As already explained, the theory that NYNEX conspired with the specific intent to subject itself, as buyer, to the monopoly power of AT&T is intrinsically implausible and inconsistent with facts conceded by Discon. At the same time, the amended complaint presents an alternative explanation for the agreement—regulatory evasion resulting in profits shared between NYNEX and AT&T—that does not in any way depend on the implausible theory of monopoly power. In these circumstances, the Section 2 conspiracy claim should be dismissed along with the Section 1 conspiracy claim. *See TV Communications Network*, 964 F.2d at 1026-27 (dismissing conspiracy-to-monopolize claim where implausibility of economic theory undermined "inference of specific intent to conspire to achieve the stated goal of the conspiracy," citing *Matsushita*, 475 U.S. at 597).

CONCLUSION

The judgment of the court of appeals should be reversed, and the district court's judgment of dismissal reinstated.

Respectfully submitted.

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
1850 M Street, NW
Washington, DC 20036
(202) 775-0184

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

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(15)

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No. 96-1570

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION, *et al.*,
Petitioners,

v.

DISCON, INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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JOINT APPENDIX

GUY MILLER STRUVE
Counsel of Record
JAMES D. LISS
VINCENT T. CHANG
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4192

JAMES R. YOUNG
JOHN THORNE
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-1600

RICHARD G. TARANTO
FARR & TARANTO
1850 M Street, NW
Washington, DC 20037
(202) 775-0184
Counsel for Petitioners

LAWRENCE C. BROWN
Counsel of Record
JOHN H. RING, III
360 Dingens Street
Buffalo, New York 14206
(716) 826-3038
Counsel for Respondent

PETITION FOR CERTIORARI FILED APRIL 4, 1997
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NOTICE

The following opinions and orders have been omitted in printing this Joint Appendix because they appear on the following pages in the appendix to the Petition for Certiorari:

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Decision and Order of the District Court, dated June 7, 1995	21a
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Order of the Court of Appeals Denying Rehearing, dated January 7, 1997	54a

Relevant Docket Entries in the District Court

Date	Docket Number	Docket Entry
5/25/90	1	Filed Complaint with jury trial demand
8/29/90	5	Filed defts' Notice of Motion to Dismiss Complaint and to Impose Sanctions (no ret)
6/24/92	19	ORDER set filing of Amended Complaint Deadline to 7/31/92; . . .; if amd complaint not filed by 7/31/92, dismissal with prejudice shall result; granting, w/o prejudice, defts' motion to dismiss; denying, w/o prejudice, defts' motion for sanctions . . .
7/31/92	20	AMENDED COMPLAINT by Discon, Inc., . . . amending complaint with jury trial demand . . .
9/14/92	23	MOTION . . . to Dismiss amended complaint & for Sanctions . . .
6/7/95	70	ORDER granting . . . motion to Dismiss amended complaint . . .
6/14/95	71	JUDGMENT in favor of defendants based on decision by court . . .
7/5/95	73	NOTICE OF APPEAL by Discon, Inc. . . .

Relevant Docket Entries in the Court of Appeals

Date	Docket Entry
11/13/95	Appellant Discon Incorporated brief FILED . . .
12/11/95	Appellees Bernard O'Reilly, Robert J. Eckenrode, New York Telephone, Nynex Material, Appellee Nynex Corporation brief filed . . .
12/26/95	Appellant Discon Incorporated reply brief filed . . .
3/27/96	Case heard before NEWMAN CH.J., OAKES, PARKER, C.JJ. . . .
8/26/96	Judgment of the district court is AFFIRMED, in part, REVERSED, in part, and remanded for further proceedings by published signed opinion filed. (JON) . . .
8/26/96	Judgment filed . . .
9/9/96	Appellees Bernard O'Reilly, Robert J. Eckenrode, New York Telephone, Nynex Material, Nynex Corporation Petition for rehearing, petition for rehearing in banc . . . filed . . .
1/7/97	Order FILED . . . DENYING petition for REHEARING . . . by Appellee Bernard O'Reilly, Robert J. Eckenrode, New York Telephone, Nynex Material, Nynex Corporation, . . ., DENYING petition . . . for rehearing in banc by Appellee Bernard O'Reilly, Robert J. Eckenrode, New York Telephone, Nynex Material, Nynex Corporation . . .

Complaint, dated March 25, 1990

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK

CIV-90-0546A

DISCON, INCORPORATED,
Plaintiff
v.
NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES,
NEW YORK TELEPHONE,
ROBERT J. ECKENRODE, BERNARD O'REILLY,
Defendants

JURY TRIAL DEMANDED

COMPLAINT

Plaintiff, Discon, Incorporated ("Discon"), alleges as follows:

NATURE OF THIS ACTION

1. This action responds to a pattern of bidrigging and other discriminatory procurement practices by which NYNEX caused its telephone subsidiaries to divert regulated funds to an unregulated affiliate, NYNEX Material Enterprises ("MECo"). NYNEX forced the telephone subsidiaries to buy from MECo, even when MECo's prices exceeded those of unaffiliated suppliers. MECo procured goods and services from these suppliers and then applied

markups as high as 1004%. MECo threatened to retaliate, and did retaliate, against suppliers who disclosed these markups to the regulated companies and offered to compete with MECo. These anticompetitive activities injured Discon, a low-cost supplier of network services.

2. Discon also alleges that MECo's practices formed part of a larger pattern of fraudulent and extortionate activity, in violation of federal racketeering law. Finally, Discon seeks relief under the General Business Law, the Public Service Law, and the common law of New York.

3. Because Robert J. Eckenrode oversaw the creation of MECo as a profit-making enterprise and participated personally in unlawful diversification, the system of diverting regulated funds to subsidize unregulated NYNEX affiliates is known as the "Eckenrode Plan." The Eckenrode Plan has artificially inflated the stated value of NYNEX's regulated ratebase by as much as $800 million.

4. The Federal Communications Commission ("FCC") has found that these activities violate its rules and has ordered NYNEX to show cause why it should not impose the largest fine in its history. In November 1987, the New York Public Service Commission ("PSC") issued a staff review indicating that "outside vendors cannot realistically compete with MECo." In May 1990, the PSC released a detailed audit report that criticized MECo's "inconsistent and unfair" treatment of suppliers of network services. The United States Department of Justice ("Justice") has informed the press that it expects to indict NYNEX in connection with various activities described herein.

JURISDICTION

5. This case arises under the federal antitrust laws, Title 9 of the Organized Crime Control Act ("RICO"), Article 22 and 22-A of the New York General Business Law ("Donnelly Act"), the New York Public Service Law, and the common law.

6. 15 U.S.C. 15 (Section 4 of the Clayton Act) confers jurisdiction over Counts One through Three.

7. 18 U.S.C. 1964 confers jurisdiction over Counts Four through Six.

8. This Court has pendant jurisdiction over Counts Seven through Thirteen.

VENUE

9. Each of the defendants does business in the Western District of New York.

10. 15 U.S.C. 22, 18 U.S.C. 1965, and 28 U.S.C. 1391 provide venue in the Western District of New York.

PARTIES

11. Plaintiff Discon is a corporation organized under the laws of the State of New York. Discon's primary business is the provision of "network services," which includes the removal, repair and installation of telephone central offices and other equipment used by telephone carriers. At times relevant to this complaint, Discon was a customer of New York Telephone ("NYT"), from which Discon obtained telephone services under tariff.

12. Defendant NYNEX Corporation ("NYNEX Corp.") is a holding company incorporated under the laws of Delaware. Its principal place of business is New York City. NYNEX's principal business is the provision of exchange service and exchange access, which it conducts through regulated subsidiaries NYT and New England Telephone & Telegraph ("NET").

13. Defendant MECo is incorporated under the laws of Delaware. NYNEX created MECo as a separate, profit-making venture responsible to the parent holding company. MECo's primary business function is procuring goods and services for NYT and NET, and for NYNEX Service Company ("NSC"), a subsidiary of the regulated telephone companies.

14. Defendant NYT is a New York corporation, which provides exchange telecommunications and exchange access in New York State and adjacent areas of Connecticut.

15. Defendant Robert J. Eckenrode is a citizen of Connecticut. As an employee of AT&T, Eckenrode served as vice president in charge of planning the structure of NYNEX, during the year prior to its divestiture. From 1984 to 1988, Eckenrode was executive vice president of NYNEX Corp. and oversaw MECo and other unregulated activities. In 1988, NYNEX Corp. named him vice chairman.

16. Defendant Bernard O'Reilly is a citizen of New Jersey. O'Reilly was a district manager of MECo who retaliated against Discon because, among other reasons, it refused to participate in attempts to defraud purchasers of scrap that MECo acquired from NYT.

17. Officers and outside counsel to NYNEX Corp., including Guy Struve, concealed information regarding the Eckenrode Plan from the board of directors. On February 15, 1990, seven of the directors claimed that they had not been involved in any way in the alleged illegalities. The board agreed to form a Special Review Committee to determine whether to commence litigation against Eckenrode and the other remaining directors.

I. BACKGROUND

18. In the face of litigation under the Sherman Act, NYNEX made specific undertakings not to discriminate against unaffiliated suppliers. Despite these commitments, NYNEX discriminated against Discon and monopolized markets for network services.

19. Until January 1, 1984, AT&T owned the Bell operating companies ("BOCs"), including NYT and NET. AT&T also owned Western Electric, now known as AT&T Technologies ("Western"), which manufactured and procured equipment for the BOCs. BOCs obtained a small

amount of equipment from unaffiliated suppliers, collectively known as the "general trade."

20. On November 20, 1974, the United States filed a civil antitrust action against defendant AT&T, which then owned NET and NYT. The action charged that AT&T (also known as the Bell System) monopolized various markets in violation of Section 2 of the Sherman Act. The principal claim was that AT&T used the BOCs' natural monopoly over exchange service to discriminate against unaffiliated suppliers and thereby extend its monopoly power into potentially competitive markets, including the markets for network equipment and network services.

21. On September 11, 1981, the United States District Court for the District of Columbia found that "the Bell System has violated the antitrust laws in a number of ways over a lengthy period of time." *United States v. AT&T*, 524 F. Supp. 1336, 1381 (D.D.C. 1981). Specifically, the Court concluded that "procurement decisions within the Bell System tend to create a predisposition within [BOC] managers in favor of Western profits and against the general trade competition." *id.*, at 1373. On August 11, 1982, this District Court found that "there was proof that AT&T used its control over the local Operating Companies to force them to buy products from Western Electric even though other equipment manufacturers produced better products or products of identical quality at lower prices." 552 F. Supp. 131, 163 (D.D.C. 1982). On August 24, 1982, AT&T entered a consent decree ("consent decree") to settle this litigation.

22. The consent decree (Section I) required that AT&T divest the BOCs.

23. In 1983, AT&T caused NYNEX Corp. and six other regional holding companies to incorporate. On January 1, 1984, as a result of the consent decree, AT&T transferred two telephone companies (NYT and NET) to NYNEX Corp.

24. The consent decree imposed obligations on NYNEX and other divested BOCs. The consent decree required the BOCs to provide equal access to interexchange carriers, which resulted in a large number of removals and installations of exchange central offices. It prohibited the BOCs from discriminating between AT&T and others in the procurement of products and services (Section II.B.1), and required them to submit procurement procedures to Justice (Section II.C). The Court of Appeals has held that Section II.B prohibits a BOC from discriminating in favor of its own affiliates. *United States v. Western Electric*, 846 F.2d 1422, 1428 (D.C. Cir.), *cert denied*, 109 S.Ct. 306 (1988).

25. The consent decree (Section III) requires each officer, employee, and agent of NYNEX and its affiliates to cooperate in ensuring that its provisions are carried out.

26. AT&T created MECo prior to divestiture and caused NYT and MECo to enter into an agreement ("MECo Supply Contract") that purported to make "available to [NYT] a procurement entity which is established, organized, staffed, and equipped to purchase products and . . . services . . . so as to achieve economies and other increased efficiencies." The agreement required MECo to maintain reasonable prices and to include them "insofar as practicable [in] published price lists." AT&T caused NYT and Western to transfer personnel to MECo. In reality, however, MECo lacked the staffing and expertise to conduct effective procurement on a competitive and independent basis. Even after divestiture, it remained predisposed to rely on AT&T.

27. NYT failed to file a copy of the MECo Supply Contract with the PSC, as required by Section 110(3) of the Public Service Law. The PSC staff reviewed the contract in November 1987 and concluded that it was incomplete and inadequate.

28. On January 1, 1984, AT&T transferred control of MECo to NYNEX Corp. AT&T failed to comply with

Section I.B of consent decree, which required that MECo receive "sufficient facilities, personnel [and] systems . . . to perform independently of AT&T." Accordingly, NYNEX Corp.'s acquisition of MECo was unlawful and does not insulate NYNEX from liability for conspiring with its illegally acquired affiliate to restrain trade. As a direct result of the unlawful defect in the acquisition, MECo perpetuated the same noncompetitive practices that prevailed prior to divestiture. These resulted in awarding Western virtually all contracts and charging excess costs into NYT's ratebase and regulated expense accounts.

29. As found by the PSC staff, "MECo's early central office equipment removal jobs demonstrated poor service to NYT and highlighted MECo's lack of experience. . . . MECo's management actually did lead to inconsistent and unfair treatment of vendors." The PSC staff concluded that NYT could have saved at least $20 million by managing removal jobs in house.

30. On July 2, 1984, NYNEX submitted a Procurement Compliance Report to Justice. This Report made a series of representations, including that:

(a) "NYNEX's overall procurement policy [is] to seek the most technically suitable and cost effective quality products/services" and "to assure that we are evenhanded in our treatment of suppliers so that we may buy the best available products and services at the lowest overall price."

(b) NYNEX has "an Open Door Policy" with "specific policy and practice guidelines . . . designed to insure that [vendors] receive equitable and fair consideration and that procurement decisions are premised upon objective and unbiased standards, adequately supported and documented."

(c) "Although [NYT] makes its own ultimate selection or procurement decision, MECo assists [it] in identifying multiple sources of supply."

(d) "MECo has established a single point of contact to investigate and respond to supplier complaints or allega-

tions of unfair treatment, including claims relating to possible discriminatory practices by NYNEX employees."

(e) Reasons for disqualifying vendors (including vendors other than Western) are documented in a specified form.

(f) Vendors (including Western) are disqualified is they fail to respond to requests for proposals by the response date.

31. Each of these representations misstated NYNEX's actual practice. In reality:

(a) NYNEX forced NYT to procure through MECo whenever possible. This enabled MECo to charge excessive markups and to price without regard to cost. MECo's excess charges not only resulted in unregulated income to NYNEX, but they also increased the revenue requirements that NYT is authorized to recover from monopoly ratepayers.

(b) NYNEX did not make its alleged "Open Door" policy available to vendors; nor did it properly document procurement decisions.

(c) NYNEX forced NYT to buy from MECo. MECo made little effort to identify multiple sources of supply; as late as 1985, there were only two outside removal vendors other than Western. NYT created an evaluation unit to document comparisons of MECo and outside vendors; this group transcribed onto its own letterhead studies fraudulently prepared by MECo personnel.

(d) There was no publicized point of contact for vendor complaints. MECo refused even to consider complaints from Discon unless it signed a release excusing all past misconduct. In another instance, a MECo district manager told Discon that if it even told anyone in NYT about a billing dispute Discon would never get work again.

(e) Discon was disqualified from jobs without reason or documentation. MECo forced Discon to decline to respond to bids placed by NYT directly; in one case, MECo even forced Discon to sign a letter MECo had prepared.

(f) MECo was not disqualified from jobs even when it did not file a timely bid. In one case, NYT even made information on Discon's pricing available to MECo and allowed it to rebid.

II. MECo's MONOPOLIZATION OF NETWORK SERVICES

32. NYT provides exchange service and exchange access to customers in New York and Connecticut. The FCC regulates NYT's charges for exchange access, the methods of accounting and depreciation, and the manner in which NYT transacts business with affiliates. The New York PSC and the Connecticut state commission regulate exchange service in the respective states. Because of NYT's monopoly power, these regulators have authority to set maximum rates. NYT is constitutionally entitled, however, to recover all reasonable costs of its regulated businesses.

33. Despite divestiture, NYT remains the dominant exchange carrier in New York State. Except for Rochester, Jamestown and Middletown, NYT serves every town and city in the State whose population exceeds 25,000. As of December 31, 1989, NYT served 89.9 percent of all network access lines in the State. In these areas, NYT supplies more than 95 percent of exchange service and exchange access.

34. As a result, NYT is the dominant purchaser of network services in New York State. The consent decree required NYT to provide equal access to interexchange service. This has required NYT to remove substantial parts of most central offices and to install new electronic switches. NYT's network service requirements have been approximately $50 million per year since divestiture.

35. Most other BOCs rely on unaffiliated contractors for removals (or use employees whose wages are charged directly into regulated accounts). NYT performs approximately 25 percent of its removals and contracts with MECo for the remainder. The purpose of this arrangement is to allow NYT to charge excess costs into regulated accounts and to generate profits at MECo, which is not subject to regulation.

36. At times relevant to this complaint, MECo's economic interests were separate from and independent of those of NYT. Because of the unlawful manner in which AT&T transferred MECo to NYNEX, MECo continued to collude with, cooperate with and depend upon AT&T and Western. MECo was not subject to utility regulation and claimed to be free to maximize its profits. On March 16, 1990, NYNEX Corp., under pressure from regulators, transferred its ownership of MECo to NYT and NET.

37. At least until March 16, 1990, NYNEX used MECo to inflate the costs that NYT recovered under state and federal tariffs and to generate unregulated profits that MECo sent to NYNEX Corp. as dividends.

38. As found by the FCC, "MECo overcharged its regulated affiliates on sales of products and services, and the regulated telephone companies in turn, passed on excessive costs to ratepayers by improperly recording the overcharges 'above the line' as regulated costs." *New York Telephone* ("*NYT*"), FCC 90-57, para. 16.

39. As found by the FCC, "notwithstanding inconsistent statements in [materials filed with the FCC], markups had a wide and inconsistent range with no discernable relationship to costs." *NYT*, para. 18.

40. The FCC staff's limited examination of six removals found markups of up to 60 percent. In 1984, however, MECo had a policy of marking up major removals by 250 percent.

41. As found by the FCC, "NYNEX's corporate purchasing policy, which required [NYT and NET] to purchase certain product lines and services through MECo in most instances, contributed to and reinforced MECo's pricing strategy." *NYT*, para. 18.

42. As found by the FCC, "MECo's return on investment for each of the five years from 1984 through 1988 far exceeded the allowable rate of return for regulated affiliates, and grew enormously." *NYT*, para. 17. MECo's return on investment for 1988 was 81 percent.

43. The FCC determined that MECo's conduct prior to January 1, 1988 was inconsistent with its rules, 47 C.F.R. 31.01-2(c) and tentatively concluded that NYT's purchase of goods and services from MECo at inflated prices constituted an unreasonable practice in violation of Section 201(b) of the Communications Act of 1934, 47 U.S.C. 201(b).

44. The FCC found that MECo's overcharges had generated excess profits of more than $118 million. This substantially understates the true magnitude of excess costs imposed by MECo. Once MECo learned that the FCC and PSC were examining its profits, however, it diverted them to other unaffiliated subsidiaries. In 1987, for example, MECo bought personal computers from NYNEX Business Information Systems ("BISC") at a price above market. The scope of the FCC audit was extremely limited; it did not reach diverted profits or excess costs associated with MECo's inefficiency and its discrimination in favor of Western.

45. Western is a major supplier of network services in New York State. Prior to divestiture, NYT advised the PSC that there were no vendors other than Western that were qualified to handle live removals. Western performed virtually all removals and installations of NYT's exchange central offices. It continues to be the exclusive supplier of network services to AT&T Communications, which operates an interexchange network in the State.

46. MECo's profitability was substantially dependent upon its relationship with Western. Western is a major supplier of electronic switches, which have comprised a major portion of NYT's $7.5 billion construction project since divestiture. Western pays MECo a year-end rebate on these purchases, which MECo retains and does not pass along to NYT. These rebates (and the shared historical tie to AT&T), contributed to the preference which MECo consistently exercised for contracting with Western, rather than general trade suppliers.

47. NYNEX and Western combined to divide the market for network services in New York State. MECo agreed to award Western most contracts on a non-competitive basis. MECo and NYT allowed Western to write job change orders (or "JIMs") to increase payments on fixed price contracts. In return for these concessions, Western agreed to serve only as a subcontractor to MECo on most contracts, which allowed MECo to mark up Western's prices.

48. An additional reason that MECo reached this accommodation was its assumption that NYT managers preferred to deal with directly with Western. MECo's original business plan stated that "attainable sales are based on the recognition that some geographic areas [of NYT] may continue to exhibit a reluctance to switch from traditional vendors of choice [*i.e.*, Western]. Therefore, MECo projections for 1985 cover 50 percent of the potential business." By dividing the market with Western as described in paragraph 47, MECo obtained control of virtually all removal contracts.

49. Employees of NYT who concluded that there was a cost advantage to purchasing from a source other than MECo were required to submit full documentation for review by superiors. Such employees were accused of not promoting "corporate synergy." They suffered adverse personnel evaluations.

III. NYNEX's DISCRIMINATION AGAINST DISCON

50. In June 1984, Robert Faltisco formed Discon and informed Robert Zirkelbach, MECo's manager of network services, that he was willing to compete with Western on any size removal.

51. In 1984 and 1985, there were only three suppliers of network services certified by MECo: Western, Discon, and LISN. From divestiture until 1989, Western has supplied at least 75 percent of the all network service contracts not performed by NYT's internal staff.

52. Discon enjoyed substantial cost advantages over Western and was able to perform removals of any size anywhere in the State. After six months, Discon had 25 employees and budgeted hiring 50 more in the following year. Discon had a perfect safety record and no service interruptions. In its first year, Discon won every competitive contract and performed more than $1.3 million in removals. Discon's growth was limited only by NYNEX's anticompetitive conduct, which forced Discon to discontinue most of its operations and to lay off most of its employees.

53. Discon provided removal services that were equal or superior in quality to Western's. Discon developed cost-saving innovations, including outside construction elevators, rotating character stamps, portable plywood walls, and safety procedures, many of which MECo encouraged Western to adopt. In June 1984, MECo determined that Discon was "as qualified as [Western] to provide removal services."

54. Prior to divestiture, Western was almost the only vendor of network services to NYT and all other BOCs. In 1984, it lowered its prices on many contracts. MECo's markups brought the prices back to near their historic level. As such, the marked up prices did not appear out-of-line to NYT managers or to regulators. MECo had

great initial enthusiasm for Discon, because it helped to lower Western's prices and to increase the margin available for MECo's own markups.

55. However, Discon inherently threatened to expose the divergent economic interests of NYT and MECo. If Discon bid directly to NYT, NYT managers would learn its true prices; they could question the NYNEX corporate policy of allowing markups. In the event that Discon's low costs became known to regulators, they could disallow the high costs that NYT passed on to its monopoly ratepayers. These concerns led MECo to discriminate against Discon, even though its lower prices could have allowed higher markups.

56. MECo discriminated against Discon and in favor of AT&T by allowing Western access to its "725" prepaid billing system. This provided for payment one month in advance of work performed. Discon's payments, by contrast, were irregular and delayed by as much as a year after performance.

57. MECo further discriminated against Discon and in favor of AT&T by refusing to provide written contracts or authorizations for three jobs, whose value exceeded a million dollars. Because this practice violated standard procurement procedures. O'Reilly demanded that Faltisco tell NYT personnel that Discon had received countersigned copies of its offers.

59. NYNEX Corp. caused NYT to discriminate against Discon and in favor of AT&T by assigning to Western its supervisory and quality control responsibilities relating to contracts awarded to Discon.

59. MECo forced Discon to accept obligations outside its contract, to forego billing job changes and to dispose of scrap on non-economic terms. O'Reilly threatened to retaliate against Discon if it did not absorb the costs added by these changes. The purpose of these changes

was to conceal losses caused by errors and irregularities in MECo's administration of contracts. These burdens discriminated against Discon and in favor of AT&T because O'Reilly did not impose similar requirements or make similar threats against Western.

60. Western used JIMs or charged extra hours on non-competitive jobs to build up a reserve to subsidize predatory pricing on jobs that were open to competitors. In connection with the removal of a 4A switch and tandem at the central office on Franklin Street in Buffalo, Western calculated a bid price of $1.7 million. In order to undercut Discon, Western bid $998,000, which was below its actual costs.

61. On June 18, 1984, Discon submitted a bid to MECo for $574,000 for the Franklin Street removal and won the contract. Without the knowledge of Discon or of NYT managers, MECo marked this up by 45 percent to $832,300. MECo sent NYT documentation in which Western's actual bid had been covertly marked up by the same percentage.

62. On July 17, 1984, Discon performed an emergency re-use removal in Chappaqua at the request of NYT Engineering. NYT told Discon that they were unable to reach anyone at MECo in a timely manner. O'Reilly upbraided Discon for dealing directly with NYT and particularly for disclosing the price of the removal, which threatened MECo's future ability to pass on undisclosed markups.

63. In mid-August 1984, NYT asked Discon to perform an emergency cable-mining job at Franklin Street, Buffalo. Discon was unable to reach anyone at MECo to discuss the request. Discon agreed to do the job for $1,000, which was far below the rates that MECo had been charging NYT for similar work performed by Discon. O'Reilly again upbraided Discon for working directly for NYT. He stated that NYNEX policy prohibited vendors from disclosing their prices to NYT.

64. In late October 1984, a NYT engineer told Faltisco that Western was complaining that Discon was awarded Franklin Street only because MECo had not marked up the Discon price as much as the Western price. As a result, Faltisco met with John Jacoy, a NYT manager, and disclosed Discon's actual price. At this time, Jacoy learned that MECo had marked up Discon's price by 45 percent. Jacoy later found that there were markups of up to 600 percent on other Discon jobs.

65. In early November 1984, Jacoy asked Discon to perform another emergency removal. Discon agreed to do the job for $20 per hour. This was substantially below Western's rate.

66. MECo sold scrap from its central offices to various dealers, including AMAX Copper. In late September 1984, O'Reilly instructed Discon by telephone to "salt" scrap at Franklin Street by placing higher grade switches on top. Discon agreed to do so, but declined affirmatively to misrepresent the truth to AMAX. Discon refused to denying that certain scrap had already been removed. The district manager said that Discon would "pay" for its failure to do so.

67. On or about November 2, 1984, O'Reilly directed Faltisco by telephone to remove wire spring relays from scrap sold to AMAX. O'Reilly warned Faltisco that he would put Discon "out of business" if it did not comply.

68. During November 1984, NYT requested that Discon submit a bid for a removal in Williamsville. Two days before the bid was due, O'Reilly caused Zirkelbach to fly to Buffalo and to demand that Discon notify NYT that it would not bid. O'Reilly told Faltisco that unless he signed the letter delivered by Zirkelbach, MECo would put Discon "out of business." The letter stated that Discon was only "prepared to accept orders [placed through] NYNEX MECo pursuant to our existing contract agreement." Zirkelbach also delivered a contract backdated to

November 1, 1984, which allowed Discon to provide network services to NYT through MECo. Zirkelbach represented that Discon should anticipate that MECo would ask it to bid on all network service projects that MECo administered. He told Faltisco that he had better prepare for Discon to "grow like hell."

69. An NYT manager telephoned Faltisco on the due date and told him that unless Discon bid on Williamsville and agreed to work directly with NYT, he would see to it that Discon never worked for NYT in the mid-Hudson region. Subsequently, both NYT and MECo excluded Discon from all requests for proposals in the mid-Hudson region.

70. Western agreed to do the Williamsville removal for the firm price of about $20,000. Western failed to complete the removal, even after submitting additional billings (JIMs) for $40,000. NYT made these additional payments over Jacoy's objection.

71. The effort of Jacoy and his superior to regain control over network service contracting was ultimately unsuccessful. William C. Ferguson, then president of NYT and now chairman of NYNEX, ordered NYT personnel to conduct all purchasing through MECo, unless they could fully document the grounds for an "exception" and obtain high-level approval. Ferguson reaffirmed this policy in February 1986. Complete control over removals returned to MECo in the Upstate area.

72. On January 1, 1985, Discon and MECo entered a general supply contract for a term of three years.

73. In February 1985, Jacoy requested a bid for removals at Jamestown and Fredonia. On March 1, 1985, NYT accepted Discon's price quote.

74. In March 29, 1985, O'Reilly falsely told Faltisco by telephone that NYT had closed billing for Franklin Street, when in fact NYT had instructed O'Reilly to ac-

cept billing for extra work that Discon had performed. Discon did not receive any portion of more than $120,000 in invoices prior to December 1989.

75. On June 19, 1985, two employees of NYT Security visited Faltisco. They threatened to make an unfavorable report about Discon unless Faltisco made a statement that Zirkelbach had extorted money from him. Faltisco declined to make the statement because it was untrue. On July 9, MECo demanded and received Zirkelbach's resignation. In an effort to defame and discredit Discon, NYT falsely told the PSC that Discon had made Zirkelbach a loan that it did not expect to be repaid.

76. During the second half of 1985, Discon performed numerous removal jobs directly for NYT in the Upstate area.

76. During the first half of 1986, Discon performed about fifteen removals for NYT. In most of these case, Discon received payment within two months.

77. In March 1986, NYT invited Discon to bid on the removal of equipment from its Cortland central office. Discon delivered a sealed, firm price bid the day before the response date. A week later, NYT returned the bid unopened stating that NYT had decided to have MECo handle the bidding.

78. In March 1986, Discon hired Zirkelbach to help on proposed work for Rochester Telephone Company. On May 29, 1986, an employee of NYT Security asked Faltisco if he had hired Zirkelbach and then told Faltisco that he was instructed to state that Discon would not be allowed to perform removals for eighteen months to two years. The following day, the employee stated that he was writing a strong recommendation that Discon be restored to the approved vendor list. The employee also agreed to supply a written copy of NYT's procurement policies.

79. On June 10, 1986, another employee of NYT Security again told Faltisco that he would not be allowed to work for MECo or NYT for a year to eighteen months. No written reason was given. NYT personnel refused to meet with Faltisco to explain the action.

80. Since at least June 1986, the improper decertification of Discon as an approved vendor for MECo or NYT and the refusal to allow Discon to submit bids has restrained Discon from competing in markets for network services and injured it in its business.

81. On September 8, 1986, a MECo employee told Faltisco that he would not be allowed to work for MECo or NYT until he signed a release and returned evidence of the illegal markups and of incidents of discrimination in favor of Western.

82. In May 1988, after an audit by the PSC, top management directed NYT to contract directly with vendors in all removals. By this time, Discon had laid off all its employees.

83. From the middle of 1988, NYT began to use separate accounts to record its estimates of illegal overcharges by MECo. In December 1988, MECo agreed to a partial refund of $42.2 million. This amount did not include any overcharges from 1984 through 1987.

THE PATTERN OF RACKETEERING

84. At relevant times, in the Western District of New York and elsewhere, the defendants unlawfully, willfully, and knowingly engaged in a pattern of racketeering activity as defined in 18 U.S.C. 1961(1) and 1961(5). The pattern included acts of wire fraud, mail fraud, fraud in the sale of securities, obstruction of justice, and violations of the Hobbs Act and of the Travel Act. These predicate acts (and other overt acts of the conspiracy) injured Discon in its business and property. The pattern extended beyond Discon to include similar acts directed at em-

ployees, suppliers, and customers of other NYNEX affiliates.

85. It was a part of the pattern of racketeering that NYNEX defrauded NYT and NET and their ratepayers by forcing NYT and NET to purchase services and equipment from MECo and other unregulated subsidiaries at inflated prices.

86. It was a part of the pattern of racketeering that senior executives of MECo, including Lawrence Friedman, solicited and accepted gratuities from vendors and fraudulently billed expenses to MECo. Personal interest in these corrupt pactices prevented these executives from implementing accounting systems and practices that would detect and expose procurement irregularities. The atmosphere of corruption at MECo deterred its employees from reporting the larger irregularities involving Western.

87. It was a part of the pattern of racketeering that NYNEX Corp., NYT, and NET failed to disclose required information in its annual, quarterly, proxy statements and special reports to the SEC.

(a) Material information that was omitted includes, but is not limited to: (1) the participation of Eckenrode in the design and implementation of the Eckenrode Plan; (2) the unlawful cross-subsidization by NET and NYT of unregulated affiliates; (3) the unlawful diversification through NYNEX subsidiaries; (4) the failure to make financial statements in accordance with generally accepted accounting principles and applicable instructions; and (4) the pendancy of criminal investigations by Justice. These facts were material to holders of securities registered by NYT, NET, and NYNEX.

(b) NYT, NET, and NYNEX materially misstated their exposure to regulatory liabilities by failing to note in the 1989 annual reports to the SEC the commencement of an FCC audit in January 1989.

88. It was a part of the pattern of racketeering that NYT and NET made materially false statements to the FCC.

(a) False statements in annual reports to the FCC included, but were not limited to, the failure to make financial statements consistent with generally acceptable accounting principals and applicable FCC instructions and regulations.

(b) NYNEX failed to include accurate information for all of its subsidiaries in the capitalization plan which, at times relevant to this complaint, it was required to file pursuant to 47 C.F.R. Part 68 (*"Computer II"*).

(c) According to the audit report of the FCC, NYNEX provided information regarding, among other items, its cash and inventory requirements. As included in the audit report, the information is false. NYNEX also falsely told the FCC staff that MECo provided NYT a "firm contract price" on removals, when in fact it allowed one vendor, Western, to bill job changes to NYT.

89. It was a part of the pattern of racketeering that NYT and NET made materially false statements to the IRS.

(a) As a result of inflated prices paid for capital equipment and capitalized expenses, the asset bases of NYT and NET is overstated by approximately ten percent. Upon information and belief, NYNEX has misstated the value of its assets on returns to the IRS. This has resulted in claims for excessive depreciation expense and improper tax credits.

(b) NYNEX also claimed as business and capital expenses payments that were illegal under state and federal laws. These payments included, but not limited to, payments to affiliates in violation of sections 90(3), 107, and 110(3) of the New York Public Service Law.

90. It was a part of the pattern of racketeering that MECo rigged bids on public utility projects, including the removal contracts at Hertel Avenue, Buffalo and Williamsville. The PSC staff found seventeen instances where NYT awarded removal contracts other than to the lowest bidder; all but three of these were awarded to Western.

91. It was a part of the pattern of racketeering that MECo extorted Discon by placing Discon in fear of economic loss unless Discon participated in unlawful conspiracies. Specifically, MECo threatened to drive Discon "out of business" unless Discon concealed its costs from NYT and helped to defraud a scrap dealer.

92. It was a part of the pattern of racketeering that NYNEX misstated its financial results on state and federal tax returns, deducted illegal payments as legitimate business expenses, and claimed excessive amounts of depreciation in violation of 29 U.S.C. 162(c)(2).

93. It was a part of the pattern of racketeering that NYNEX has caused NYT and NET to subsidize "One-of-a-Kind" services to large customers. NYNEX provides these services below cost in order to prevent the development of economic alternatives (including cable) to its wireline monopoly. NYNEX covers its losses by including these costs in its revenue requirement for tariffed, monopoly services in violation of PSC Order No. 911. Even though these networks lost money, NYT paid huge sales commissions to BISC, an unregulated subsidiary of NYNEX. Since these commission drove NYT's net revenues from these contracts further below the floor of marginal costs they increased the subsidy imposed on residential ratepayers. The sales commissions were fraudulent because (1) they exceeded BISC's actual costs and (2) NYT failed to disclose to the PSC that its marginal costs exceeded revenues after it paid BISC these commissions.

94. It was a part of the pattern of racketeering that NYNEX caused a payment to be made to a discharged

employee of NET who had complained that non-economic transactions with affiliates violated the consent decree. According to her attorney, NET entered into a generous financial settlement on the stated grounds of age discrimination. One of the terms of the settlement was that the discharged employee could not disclose her allegations to Justice.

95. It was a part of the pattern of racketeering that NYNEX placed employees who questioned the Eckenrode Plan and other violations of the consent decree in fear of economic loss. NYNEX agreed to allow and require its employees to carry out the provisions of the consent decree. By contrast, NYNEX fired employees, including Zirkelbach, Michael Burkart, and Tobias Squitieri, who refused to participate in unlawful activities. MECo also retaliated against one of these employees by withholding approximately $21,000 in expense vouchers.

96. NYNEX, which includes NYNEX Corp. and each of its subsidiaries, is an enterprise, as defined in 18 U.S.C. 1961(4). NYT and BISC are also enterprises, as defined in 18 U.S.C. 1961(4). Each enterprise includes attorneys, accountants and other agents whom NYNEX has engaged. Each is an entity or group of individuals associated in fact who engage in and whose activities affect interstate commerce.

97. Each of the schemes that paragraphs 85 through 95 describe involves predicate acts of racketeering, as defined by 18 U.S.C. 1961(1). These predicate acts include, but are not limited to the following:

MAIL FRAUD

98. The use of the United States mails was an integral part of the artifices to defraud described in paragraphs 85 through 90 of this Complaint. Among other fraudulent objectives, NYNEX Corp. and MECo used the United States mail to deceive and defraud Discon, other customers

and suppliers of NYT, and responsible governmental authorities into reasonably believing that MECo was implementing a fair and lawful bidding procedure for NYT procurement.

99. The fraudulent use of the United States mail included, but was not limited to, (a) the mailing by MECo of work assignments on more than 12 occasions from 1984 to 1986; (b) a letter mailed by Richard Bird of NYT on or about December 10, 1985; (c) letters mailed by Waldon Rutter of NYT on March 18, and March 24, 1986, (d) letters mailed by Robert Williams of MECo on or about February 4, 1987 and April 7, 1987; (e) a letter by John Fehr of NYT mailed on or about February 23, 1987, and (f) a letter mailed by Kevin O'Sullivan on or about October 29, 1987. Other fraudulent mail communications are in defendants' exclusive possession and can be uncovered only through discovery.

100. The fraud described in paragraphs 85 through 90 injured Discon in its business (1) by causing Discon to expend resources on preparing bids that were fraudulently represented to be competitive, (2) by causing Discon to expend funds working on contracts said to be awarded to Discon, but then diverted to Western, (3) by causing state and federal authorities to delay or to forego efforts to prevent the illegal transactions that diverted NYT contracts to Western and MECo, and (4) by causing Discon to pay higher telephone rates.

101. Each use of the United States mail is furtherance of the artifices to defraud described in this Complaint constitutes a predicate act.

WIRE FRAUD

102. The use of intrastate and interstate wire communications was an integral part of the artifices to defraud described in paragraphs 85 through 90 of this Complaint. Among other fraudulent objectives, NYNEX

Corp. and MECo used wire communications to deceive and defraud Discon, other customers of NYT, and responsible governmental authorities into reasonably believing that MECo was implementing a fair and lawful bidding procedure for NYT procurement.

103. Specific wire communications that were fraudulent included, but were not limited to, numerous telephone communications between Discon and representatives of MECo and NYT, in which MECo and NYT fraudulently represented that the procurement procedures were fair, orderly and even-handed. On January 18, 1985, O'Reilly tried to defraud Discon in a telephone call. In phone calls between Frank Turrock of MECo, and Faltisco on August 26, 1986 and September 8, 1986, MECo attempted to defraud Discon in connection with bidrigging and outstanding invoices. In a series of phone calls during January and February 1987, Williams also attempted to defraud Discon in connection with outstanding invoices.

103A. An integral part of the schemes to defraud was the remote access by MECo through wire communications of computerized order entry and billing systems. MECo used these systems, known as 725, PEARS, RIS, CB&C, RMDS, TTOES, SHOES, CAPRI, ECRS, PCNIS, CUCRIT, and LIFECOST, to place fraudulent orders and bills to NYT.

103B. Other fraudulent wire communications are in defendants' exclusive possession and can be uncovered only through discovery.

104. The fraud described in paragraphs 85 through 90 injured Discon in its business (1) by causing Discon to expend resources on preparing bids that were fraudulently represented to be competitive, (2) by causing Discon to expend funds working on contracts said to be awarded to Discon, but then diverted to Western, (3) by causing state and federal authorities to delay or to forego efforts to prevent the illegal transactions that diverted NYT con-

tracts to Western and MECo, and (4) by causing Discon to pay higher telephone rates.

105. Each use of the telephone or electronic mail in furtherance of the artifices to defraud described in this Complaint constitutes a predicate act.

FRAUD IN THE SALE OF SECURITIES

106. Defendants misrepresented and failed to disclose facts regarding the assets, expenses, and legal proceedings affecting NYT and NET that were material to owners of registered debt securities of NYT, NET, and NYNEX.

107. Defendants misrepresented and failed to disclose facts regarding legal proceedings that were material to owners of registered equity securities of NYNEX.

108. Each of these acts and omission violated and continue to violate statutory and common law restrictions on fraud in the sale of securities.

109. The fraud in securities injured Discon in its business (1) by allowing NYNEX Corp. to obtain financing for operations that competed with Discon on terms that were more favorable than would have been available if the truth had been disclosed and (2) by causing state and federal authorities to delay or to forego efforts to prevent the illegal transactions that diverted NYT contracts to Western and MECo.

HOBBS ACT

110. It was a part of the part of racketeering that O'Reilly caused scrap in Franklin Street that had been sold to AMAX to be removed and transported to New Jersey and overseas.

112. The theft of these goods injured Discon because O'Reilly retaliated against Discon when it refused to misrepresent facts regarding the theft from AMAX.

110. Defendants' repeatedly extorted Discon by threatening to withhold business or to "put Discon out of business" unless Discon participated in illegal conspiracies.

111. Defendant NYNEX Corp. caused its attorneys to extort the employer of a former NYNEX executive who was providing information regarding Discon to Justice.

112. These acts of extortion injured Discon in its business (1) by causing Discon to become potentially involved in illegal conspiracies, (2) by retaliating against Discon for its failure to participate in illegal conspiracies, and (3) by deterring individuals from providing information regarding Discon to Justice.

113. Each of these acts of extortion violated 18 U.S.C. 1951 and constitutes a predicate act of racketeering.

TRAVEL ACT

114. Joseph Perk and William Flynn of NYT Security travelled from New York to Ohio and from New York to New Jersey in attempts to extort vendors into making false statements against a MECo employee.

115. Lawrence Friedman and other MECo executives travelled from New York to Florida for the purpose of extorting gratuities from vendors seeking business from NYT.

116. Albert Halprin travelled from Virginia to New York for the purpose of agreeing to extort the employer of a person who was providing information regarding Discon to Justice.

117. These trips injured Discon in its business (1) by causing Discon to become potentially involved in illegal conspiracies, (2) by retaliating against Discon for its failure to participate in illegal conspiracies, and (3) by deterring individuals from providing information regarding Discon to Justice.

118. Each of these trips, which were undertaken for the purpose of violating 18 U.S.C. 1951, violated 18 U.S.C. 1952 and constitutes a predicate act of racketeering.

OBSTRUCTION OF JUSTICE

119. Defendants' attempts to conceal information and to delay proceedings in Justice's criminal investigation and in related civil litigation, constitute obstructions of justice.

120. These acts injured Discon in its business (1) by delaying and obstructing enforcement action against illegal acts directed at Discon and (2) by allowing those illegal acts to continue.

121. Each of the acts described above that had the corrupt motivation of delaying these proceedings or concealing information violates 18 U.S.C. 1513 and constitutes a predicate act of racketeering.

OBSTRUCTION OF A CRIMINAL INVESTIGATION

122. By making a financial settlement contingent upon failing to disclose facts to Justice, NYNEX obstructed the conduct of a criminal investigation.

123. These acts injured Discon in its business (1) by delaying and obstructing enforcement action against illegal acts directed at Discon and (2) by allowing those illegal acts to continue.

124. Each such act violates 18 U.S.C. 1510 and constitutes a predicate act of racketeering.

FIRST COUNT
15 U.S.C. 1
(SHERMAN ACT, Section 1)

125. Plaintiff realleges paragraphs 1 through 124 as if fully set forth herein.

126. NYNEX Corp. acquired MECo from AT&T in violation of the consent decree. NYNEX Corp. and NYT conspired with MECo to restrain trade in network services by (1) excluding Discon from bidding directly on regulated projects of NYT and (2) awarding ostensibly competitive bids for other regulated projects to MECo and Western when these companies did not have the best offer.

127. MECo and Western entered into an arrangement to divide the market for network services in New York State and contiguous areas by (1) agreeing that Western would not deal directly with NYT and (2) agreeing that MECo would award virtually all its contracts from NYT to Western as a subcontractor. MECo furthered this agreement by using its authority to certify vendors to exclude Discon and other unaffiliated suppliers from all but a token number of jobs. As a result of this agreement, MECo was able to charge large markups, which NYNEX Corp. caused NYT unlawfully to pass on to monopoly ratepayers.

128. NYNEX Corp. engaged attorneys and accountants to participate in this conspiracy by concealing information from responsible government authorities.

129. NYNEX Corp. and MECo's participation in this combination and in the related conspiracies has violated and continues to violate Section 1 of the Sherman Act, 15 U.S.C. 1.

130. These violations have injured Discon in its property and business. Defendants are therefore jointly and severally liable to Discon for money damages in an amount equal to three times the amount directly and proximately caused. This sum is unknown at this time, but believed to be in excess of $45 million.

131. No remedy at law is adequate to compensate Discon for continuing violations. Discon will suffer additional and irreparable harm unless defendants desist from these violations. Accordingly, this Court should enjoin the continuing violations.

SECOND COUNT
15 U.S.C. 2
(SHERMAN ACT, Section 2)

132. Discon realleges paragraphs 1 through 131 as if fully set forth herein.

133. NYNEX Corp. and MECo attempted to monopolize, and did monopolize, markets for network services in New York State and in contiguous areas. NYNEX and MECo effectively controlled the price at which contracts for network services were obtained. NYNEX and MECo acquired and maintained power to restrict or eliminate competition in this market.

134. Under this arrangement, MECo and Western have maintained at least 75 percent of the market for network services in New York State. The arrangement has substantially lessened and eliminated competition in the market for network services, including the removal, repair and installation of central office equipment in New York and in parts of contiguous states.

135. Because of the restrictions of the consent decree, the regulatory, technical and economic requirements of NYT for network services differ from those of interexchange and independent local carriers in and adjacent to its service area (which includes most of New York State and parts of Connecticut). At times relevant to this complaint, MECo and Western maintained at least 95 percent of the NYT market for network services.

136. This attempt to monopolize and monopolization violated Section 2 of the Sherman Act, 15 U.S.C. 2.

137. These violations injured Discon in its business and property. Defendants are therefore jointly and severally liable to Discon for money damages in an amount equal to three times the amount directly and proximately caused, unknown at this time, but believed to be in excess of $45 million. Discon is also entitled to equitable relief for the reasons stated in paragraph 131.

THIRD COUNT
15 U.S.C. 2
(CONSPIRACY TO MONOPOLIZE)

138. Discon realleges paragraphs 1 through 137 as if fully set forth herein.

139. NYNEX Corp. and MECo combined and conspired with others, including NYT, Western, and LISN, to violate Section 2 of the Sherman Act by monopolizing the markets for network services in New York State.

140. These acts injured Discon in its business and property. Discon is entitled to legal and equitable relief for the reasons set forth in paragraph 130 and 131.

FOURTH COUNT
18 U.S.C. 1962(a)
(RICO)

141. Discon realleges paragraphs 1 through 140 as if fully set forth herein.

142. Through a pattern of racketeering activity, MECo and NYT generated income. MECo and NYT distributed much of this income to NYNEX Corp. or to its subsidiaries. NYNEX Corp., Eckenrode and others caused this income to be invested in enterprises, in violation of 18 U.S.C. 1962(a).

143. The investment by NYNEX Corp. and NYT in MECo enabled MECo to establish its certification process, which NYNEX used to discriminate against Discon.

144. Through noneconomic transfers, MECo invested monies in BISC, and BISC invested monies in Telco Research. The purpose of these chained investments was to disguise the excessive profits that MECo earned by sending them to loss-making affiliates.

145. NYNEX Corp. and others also caused income to be invested in payments, such as that described in para-

graph 122, that required the recipient not to cooperate with state and federal investigators.

146. These acts injured Discon in its business and property by (1) financing MECo's discrimination against Discon, (2) disguising MECo's fraudulent and discriminatory schemes from state and federal regulators, and (3) causing NYT to charge Discon higher telephone rates. Defendants are therefore jointly and severally liable to Discon for money damages in an amount equal to three times the amount directly and proximately caused, unknown at this time, but believed to be in excess of $45 million.

FIFTH COUNT
18 U.S.C. 1962(b)
(RICO)

147. Discon realleges paragraphs 1 through 146 as if fully set forth herein.

148. NYNEX Corp., MECo, Eckenrode and other persons unlawfully and knowingly maintained an interest in and control of NYT through a pattern of racketeering activity, in violation of 18 U.S.C. 1962(b).

149. These acts injured Discon in its business and property. Discon is entitled to damages for the reasons set forth in paragraph 146.

SIXTH COUNT
18 U.S.C. 1962(c)
(RICO)

150. Discon realleges paragraphs 1 through 149 as if fully set forth herein.

151. NYNEX Corp., MECo, Eckenrode, O'Reilly and other persons unlawfully and knowingly conducted and participated in the affairs of NYT through a pattern of racketeering activity, in violation of 18 U.S.C. 1962(c).

152. NYNEX Corp., Eckenrode, O'Reilly and other persons unlawfully and knowingly conducted and participated in the affairs of MECo through a pattern of racketeering activity, in violation of 18 U.S.C. 1962(c).

153. These acts injured Discon in its business and property. Discon is entitled to damages for the reasons set forth in paragraph 146.

SEVENTH COUNT
18 U.S.C. 1962(d)
(RICO CONSPIRACY)

154. Discon realleges paragraphs 1 through 153 as if fully set forth herein.

155. Defendants conspired and agreed to violate 18 U.S.C. 1962(a), (b), and (c), in violation of 18 U.S.C. 1962(d).

156. Defendants committed other overt acts in furtherance of the conspiracy. These acts included, but were not limited to, (a) the predicate acts of racketeering enumerated in paragraphs 97 through 123 and (b) all acts, whether or not otherwise lawful, that furthered the schemes described in paragraphs 85 through 95.

157. These acts injured Discon in its business and property. Discon is entitled to damages for the reasons set forth in paragraph 146.

EIGHTH COUNT
DONNELLY ACT

158. Discon realleges paragraphs 1 to 157 as if fully set forth herein.

159. Defendants' conduct actually restrained competition in the market for network services in New York State.

160. Defendants' activities violated the General Business Law of New York, Article 22, Section 340.

161. These acts injured Discon in its business and property. Discon is entitled to legal and equitable relief for the reasons set forth in paragraph 130 and 131.

NINTH COUNT
DECEPTIVE BUSINESS PRACTICE

162. Discon realleges paragraphs 1 to 161 as if fully set forth herein.

163. The fraudulent schemes described in paragraphs 85 to 90 constitute deceptive business practices within the meaning of the General Business Law of New York, Article 22-A, Section 349.

164. The deceptive business practices have been recurrent in nature and offensive to the public interest.

165. These acts injured Discon in its business and property. Discon is entitled to damages for the reasons set forth in paragraph 146.

TENTH COUNT
NEW YORK PUBLIC SERVICE LAW

166. Discon realleges paragraphs 1 to 165 as if fully set forth herein.

167. NYNEX Corp. has caused NYT not to file the MECo supply contract to the PSC, as required by the Public Service Law of New York, Article 6, Section 110(3). The payments in excess of reasonable costs that NYNEX Corp. has caused NYT to make to MECo pursuant to this contract are unlawful.

168. NYNEX Corp. and MECo have caused NYT to grant an unreasonable preference or advantage to MECo and to Western in its procurement of network services. This preference constitutes a willful violation of Article 5, Section 90(3) of the Public Service Law.

169. These acts injured Discon in its business and property. Pursuant to Article 5, Section 93 of the Public

Service law, defendants are jointly and severally liable to Discon for money damages caused by these violations. The amount of these damages is unknown at this time, but believed to be in excess of $15 million.

ELEVENTH COUNT
PRIMA FACIE TORT

170. Discon realleges paragraphs 1 to 169 as if fully set forth herein.

171. Through these acts, defendants intentionally caused economic injury to Discon in retaliation for Discon's attempts to compete.

172. Many of these acts, including (but not limited to) the refusal of MECo to deal with Discon, had no motivation other than the desire to injure Discon.

173. Defendants have committed prima facie tort, in violation of the common law of the state of New York.

174. These acts injured Discon in its business and property. Defendants are therefore jointly and severally liable to Discon for money damages in an amount unknown at this time, but believed to be in excess of $15 million.

175. Defendants' actions were directed at the public generally because it sought to defraud ratepayers, bondholders and others of as much as $800 million. To deter recurrence of this conduct, this Court should award punitive damages in the amount of $30 million.

TWELFTH COUNT
THIRD PARTY BENEFICIARY
(MECo SUPPLY CONTRACT)

176. Discon realleges paragraphs 1 to 175 as if fully set forth herein.

177. The MECo Supply Contract requires MECo to maintain reasonable prices and to publish a price list.

178. These provisions seek to induce the general trade to supply NYNEX through MECo by assuring suppliers that MECo will not unreasonably mark up their prices. The disclosure of MECo's prices also allows suppliers to determine where they can effectively compete and reduce prices to NYT and its ratepayers.

179. The MECo supply contract is governed by New York law.

180. These provisions specifically benefit Discon and other general trade suppliers, which can enforce them as third-party beneficiaries.

181. MECo breached its obligation to maintain reasonable, published prices.

182. These acts injured Discon in its business and property, for the reasons stated in paragraph 130.

THIRTEENTH COUNT
THIRD PARTY BENEFICIARY
(CONSENT DECREE)

183. Discon realleges paragraphs 1 to 182 as if fully set forth herewith.

184. The consent decree, which is a court order, also includes a contract whereby AT&T made certain undertakings in return for Justice's agreement not to continue its antitrust action.

185. The contract includes the commitments described in paragraph 24, including the obligation not to discriminate in procurement and to submit a Procurement Compliance Plan.

186. The contract, which expressly required NYNEX to submit a Procurement Compliance Plan, implies a term that the Plan accurately states policies with which NYNEX will attempt in good faith to comply.

187. This contract is governed by the law of the District of Columbia.

188. Defendants are successors to AT&T's obligations under this contract.

189. Discon is a third party beneficiary that may enforce NYNEX contractual obligation not to discriminate in procurement and to comply with the policies stated in the Procurement Compliance Plan.

190. NYNEX's breach of these contractual obligations injured Discon in its business and property. Discon is entitled to damages for the reasons set forth in paragraph 130.

FOURTEENTH COUNT
BREACH OF CONTRACT
(STANDARD SUPPLY CONTRACT)

191. Discon realleges paragraphs 1 to 190 as if fully set forth herewith.

192. The contract described in paragraph 68 implies a covenant of fair dealing, including implied terms (1) that MECo will not arbitrarily disqualify or retaliate against Discon; (2) that MECo would not rig bids or otherwise discriminate against Discon; and (3) that MECo would not force Discon to perform services outside awarded contracts without compensation.

193. MECo's breach of this contract, which NYNEX Corp. induced, injured Discon in its business and property.

FIFTEENTH COUNT
COMMON LAW DEFAMATION

194. Discon realleges paragraphs 1 to 193 as if fully set forth herewith.

195. The false statement made to the PSC that Discon did not intend to receive repayment for the loan requested by a MECo employee injured Discon's reputation and de-

layed action by the PSC against MECo's unlawful procurement practices.

196. NYNEX Corp. attempted to prevent the PSC from disclosing that the defamation had occurred. In May 1990, the PSC determined that its argument lacked any basis in law. Upon information and belief, NYNEX Corp. and MECo may have fraudulently concealed similarly defamatory statements made to prospective customers of Discon.

197. These acts injured Discon in its business and property. Defendants are liable to Discon in an amount not yet ascertained.

SIXTEENTH COUNT
CIVIL CONSPIRACY

198. Discon realleges paragraphs 1 to 197 as if fully set forth herewith.

199. Defendants agreed with other persons known and unknown ("conspirators") to commit the illegal acts described in Counts One through Twelve.

200. The conspirators committed over acts in furtherance of this agreement that injured Discon.

201. Defendants are liable for any adverse consequences of such acts.

202. These acts injured Discon in its business and property. Defendants are liable to Discon in an amount not yet ascertained.

WHEREFORE, plaintiff demands trial by jury and prays for an award of threefold the damages suffered by virtue of the antitrust and racketeering conspiracies, plus additional actual and punitive damages and interest, reasonable attorneys' fees and other costs associated with this suit, in an amount not yet ascertained, but believed to

exceed $75 million; and for an Order granting such further relief as the Court deems just and proper.

Dated: May 25, 1990

/s/ George J. Navagh
GOLDSTEIN, NAVAGH,
BULAN & CHIARI
By: George J. Navagh, Esq.
14 Lafayette Square
Suite 1440
Buffalo NY 14208
(716)-854-1332

Decision and Order of the District Court,
dated June 23, 1992

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

90-CV-546A

DISCON INCORPORATED,
Plaintiff,

v.

NYNEX CORPORATION,
NYNEX MATERIAL ENTERPRISES,
NEW YORK TELEPHONE,
ROBERT J. ECKENRODE, BERNARD O'REILLY,
Defendants.

DECISION AND ORDER

INTRODUCTION

Defendants, NYNEX Corporation ("NYNEX"), NYNEX Material Enterprises ("MECo"), New York Telephone, Robert J. Eckenrode ("Eckenrode"), and Bernard O'Reilly ("O'Reilly"), have moved to dismiss plaintiff Discon, Incorporated's ("Discon") complaint (the "Complaint"), pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6). They have also moved, pursuant to Fed. R. Civ. P. 11, for sanctions against Discon and its counsel for signing the Complaint because it was not well grounded in fact, law, or a reasonable argument for extension of existing law.

After reviewing the submissions of the parties and hearing argument from counsel, the Court grants defendants'

motion to dismiss the Complaint for failure to state a claim, without prejudice. Defendants' motion for sanctions is denied, also without prejudice.

DISCUSSION

I. *Motion To Dismiss*

In deciding defendants' motion to dismiss the Complaint for failure to state a claim upon which relief can be granted, the Court accepts the well-pleaded factual allegations of the Complaint as true. *Branum v. Clark*, 927 F.2d 698, 705 (2d Cir. 1991) (citing *Cooper v. Pate*, 378 U.S. 546 (1964) (per curiam); *Dwyer v. Regan*, 777 F.2d 825 (2d Cir. 1985), *modified on other grounds*, 793 F.2d 457 (2d Cir. 1986)). The allegations of the Complaint must be construed in Discon's favor. *Papasan v. Allain*, 478 U.S. 265, 283 (1986); *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). Indeed, the Court cannot grant the motion to dismiss unless " 'it is clear that no relief [can] be granted under any set of facts that [can] be proved consistent with the allegations.' " *H.J., Inc. v. Northwestern Bell Tel.*, 492 U.S. 229, 249-50 (1989) (quoting *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984)); *see also Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

Application of these familiar principles must be tailored to the circumstances of the case and the nature of the claims that are asserted. *Ricciuti v. New York City Transit Auth.*, 941 F.2d 119, 124 (2d Cir. 1991). In so doing, the Court concludes that Discon's Complaint must be dismissed. However, since dismissal of a complaint pursuant to Rule 12(b)(6) should ordinarily be on terms giving the plaintiff a fair opportunity to correct pleading defects, the dismissal is without prejudice. *See id.* at 123.

A. *The Complaint*

Plaintiff Discon is incorporated in New York State and does business here. It was formed in June of 1984 by

Robert Faltisco to enter the business of providing "network services," which includes the removal, repair and installation of telephone central offices and other equipment used by telephone carriers. The only business activities of Discon described in the Complaint, however, consist of the removal of scrap telephone equipment. Complaint ¶ 50.

Discon was formed to meet a demand created by the January 1, 1984 court-ordered break up of American Telephone and Telegraph Company and its affiliates Western Electric Company, Inc., and Bell Telephone Laboratories, Inc. (collectively "old AT&T") into competing enterprises. Among other things, the terms of the break up of old AT&T require that all carriers of telephone calls between different exchanges have access to other exchanges that are equal in type, price and quality to the access provided to AT&T and its affiliates. *See United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 227 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).[1] To adhere to this requirement, telephone carriers found it necessary to replace equipment in their many central offices with equipment compatible with that of other carriers.

From the time it was formed in June of 1984, through 1986, Discon supplied central office equipment removal services to New York Telephone. New York Telephone is a provider of local telephone exchange service in most of New York State and in some portions of Connecticut.

[1] The description of the break up of old AT&T alleged in Discon's Complaint is incoherent. The Court has examined portions of Judge Greene's decision approving the Modified Final Judgment in *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983), to shed light on the factual background to the Complaint. *See Kramer v. Time Warner Inc.*, 937 F.2d 767, 773 (2d Cir. 1991) (factual matters not incorporated in a complaint may be considered on a motion to dismiss under Rule 12(b)(6) if they are proper for judicial notice).

New York Telephone was Discon's principal customer, if not its only one.

New York Telephone is a wholly owned subsidiary of NYNEX. Because New York Telephone is in a business subject to the New York State Public Service Law, its profits are regulated. NYNEX's, on the other hand, are not.

AT&T Technologies, Inc. ("Technologies") is the former Western Electric Company, Inc., and it is a supplier of network services among its other operations. The Complaint refers to Technologies as "Western." In the course of its network services business, Technologies supplies central office equipment removal services to New York Telephone. Technologies was Discon's number one competitor.

Discon alleges that NYNEX, New York Telephone and Technologies conspired to prevent Discon from supplying network services to New York Telephone. It further alleges that NYNEX made another of its subsidiaries, MECo, New York Telephone's purchasing agent, and that MECo favored Technologies over Discon when purchasing central office equipment removals required by New York Telephone.

MECo was allegedly motivated to favor Technologies over Discon, and to undermine Discon, so that it could markup the price of central office removals it was charging its regulated affiliate, New York Telephone. MECo's inflated prices for central office removals made for high profits, some of which MECo paid to NYNEX as dividends. The alleged arrangement thereby permitted NYNEX, MECo and Technologies to realize exorbitant profits on central office removals at the expense of New York Telephone's ratepayers that were beyond regulatory scrutiny.

Discon alleges that it "inherently" threatened to expose the divergent economic interest of New York Telephone

and MECo. For example, if Discon started to bid directly to New York Telephone, New York Telephone managers would learn its true prices and would then question the NYNEX policy of allowing markups. Likewise, in the event that Discon's low costs became known to regulators, they could disallow the high costs that New York Telephone passed on to its ratepayers. Discon alleges that these concerns led MECo to discriminate against Discon, even though its lower prices could have allowed higher markups.

Discon continued to do work for New York Telephone until June 1986, when it was suspended as a supplier eligible to offer central office removal services to New York Telephone. The Complaint alleges that Discon stopped working for New York Telephone after Discon hired a former employee of MECo, Robert Zirkelbach. Zirkelbach had resigned from MECo on July 9, 1985 after an internal investigation by New York Telephone Security. The Complaint states that New York Telephone "falsely told the [Public Service Commission] that Discon had made Zirkelbach a loan [while Zirkelbach was working for MECo] that it did not expect to be repaid." Complaint ¶ 75.

The Complaint refers to a number of alleged incidents in which defendants treated Discon unfairly. According to the Complaint, "MECo forced Discon to accept obligations outside its contract, to forego billing job changes and to dispose of scrap on non-economic terms." Complaint ¶ 59. Further, MECo executives "upbraided" Discon for dealing directly with New York Telephone and disclosing the price of a removal job. Complaint ¶¶ 62-63. The Complaint also alleges that O'Reilly instructed Discon "to 'salt' scrap . . . . by placing higher grade switches on top," Complaint ¶ 66, and "directed Faltisco . . . to remove wire spring relays from scrap sold to AMAX [Copper]." Complaint ¶ 67. It further alleges that MECo discriminated against Discon and in favor of Technologies

by allowing Technologies to use a prepaid billing system, Complaint ¶ 56, and by awarding Technologies written contracts and authorizations for three jobs whose value exceeded one million dollars. Complaint ¶ 57.

Discon alleges that, as a result of defendants' actions, it was forced to discontinue most of its business operations. It claims to be a victim of the same kind of anti-competitive conduct that led to the breakup of the old AT&T in the early 1980's and seeks damages likely to be in excess of $45,000.000.[2]

B. *Restraint of Trade Claim*

Section 1 of the Sherman Act provides that: "Every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1. The First Count of the Complaint purports to allege that NYNEX, New York Telephone and MECo conspired to restrain trade in network services in violation of § 1 of the Sherman Act. Complaint ¶¶ 125-31. More specifically, it alleges that NYNEX conspired with its subsidiaries, MECo and New York Telephone, as well as with Technologies, to exclude Discon from New York Telephone's network services business and to award virtually all of the work to Technologies. Complaint ¶¶ 126-127.

The Sherman Act was enacted "for 'the protection of *competition*' " in business and commercial transactions. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (emphasis in original)). To state a claim under § 1 of the Sherman Act, Discon

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[2] Technologies is named as a defendant in a related action filed by Discon that is pending before this Court. *Discon, Inc. v. AT&T Technologies, Inc.*, Civ. 90-954A. The *AT&T Technologies, Inc.* case involves similar theories of recovery and a motion to dismiss is pending.

must allege that: (1) the NYNEX defendants entered into a "contract, combination . . . or conspiracy"; and (2) that the conspiracy was "in restraint of trade or [interstate] commerce." *See International Distribution Centers, Inc. v. Walsh Trucking*, 812 F.2d 786, 793 (2d Cir.), *cert. denied*, 482 U.S. 915 (1987). Because Discon alleges neither conduct restraining trade nor a conspiracy, its first claim fails to state a cause of action upon which relief can be granted. Accordingly, it is dismissed.

The Complaint alleges that "NYNEX Corp. and New York Telephone conspired with MECo to restrain trade." Complaint ¶ 126. This accusation fails to state a claim because the Complaint admits that New York Telephone and MECo are wholly owned subsidiaries of NYNEX, Complaint ¶¶ 12-13, and the Supreme Court has held that, as a matter of law, a corporation and its wholly owned subsidiaries "are incapable of conspiring with each other for purposes of § 1 of the Sherman Act." *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 777 (1984).

In *Copperweld*, the Supreme Court held that "the coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise for purposes of § 1 of the Sherman Act." *Id.* at 771. Restraint of trade by a single enterprise, without a conspiracy or combination, is not unlawful under § 1. *Id.* at 767 n.13. The Court concluded that it is impossible for a corporation and its wholly owned subsidiary to conspire with each other under § 1 and that:

> [i]ndeed, the very notion of an "agreement" in Sherman Act terms between a parent and a wholly owned subsidiary lacks meaning . . . [I]n reality a parent and a wholly owned subsidiary *always* have a "unity of purpose of common design." They share a common purpose whether or not the parent keeps a tight rein over the subsidiary; the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests.

Id. at 771-72 (quoting *American Tobacco Co. v. United States*, 328 U.S. 781-810 (1946) (emphasis in original)). Thus, under *Copper-weld*, any claim that NYNEX, New York Telephone and MECo conspired to violate § 1 must be dismissed. *See Frantz v. United States Powerlifting Fed.*, 836 F.2d 1063, 1064-67 (7th Cir. 1987).

In addition to the intracorporate "conspiracy" alleged in ¶ 126, the Complaint also alleges that:

> MECo and [Technologies] entered into an agreement to divide the market of network services in New York State and contiguous areas by (1) agreeing that [Technologies] would not deal directly with [New York Telephone] and (2) agreeing that MECo would award virtually all its contracts from [New York Telephone] to [Technologies] as a subcontractor.

Complaint ¶ 127. The alleged arrangement is not a "horizontal" division of a market between competitors, but is, instead, a "vertical" arrangement between a buyer of services, the NYNEX companies, and a seller of services, Technologies. This allegation fails to state a claim under § 1 of the Sherman Act because the facts alleged in the Complaint show only a unilateral decision by the NYNEX companies to deal with Technologies and not to deal with Discon.

A company "of course generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984); *see also United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *Pants 'N' Stuff Shed House, Inc. v. Levi Strauss & Co.*, 619 F. Supp. 945, 947 (W.D.N.Y. 1985). The Supreme Court has held that the Sherman Act permits a company to announce that it will do business only with companies that acquiesce

to certain nonprice conditions and to refuse to do business with those who fail to comply. *See, e.g., Monsanto,* 465 U.S. at 761; *Colgate,* 250 U.S. at 307.

The Second Circuit has stressed that when a firm stops purchasing from one supplier and starts purchasing from another, "the fact that an agreement between the buyer and the new supplier is necessarily involved does not make it an illegal conspiracy" under the Sherman Act. *Nifty Foods Corp. v. Great Atl. & Pac. Tea Co.,* 614 F.2d 832, 841 (2d Cir. 1980) (citations omitted). Even if the new supplier "solicited the transfer of business" from the buyer, it would not constitute an illegal conspiracy. *Id.; see also Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.,* 416 F.2d 71, 78 (9th Cir. 1969), *cert. denied,* 396 U.S. 1062 (1970). Section 1 of the Sherman Act will only be implicated when there is a conspiracy with other parties "in an effort to force [a seller] to comply with fixed prices." *Pants 'N' Stuff Shed House, Inc.,* 619 F. Supp. at 947.

In the instant case, the Complaint does not allege a conspiracy between NYNEX and other parties "to force [a seller] to comply with fixed prices." It merely alleges that NYNEX announced in advance that it would only do business with companies that dealt with MECo rather than with New York Telephone directly, and that it refused to do business with those who failed to comply with this condition. This is a nonprice condition that is not violative of § 1 of the Sherman Act so long as it was implemented independently. *Monsanto,* 465 U.S. at 761. Thus, in order to succeed on its § 1 restraint of trade claim, Discon must be prepared to prove, through direct and circumstantial evidence, facts tending to exclude the possibility that NYNEX's conduct was unilaterally undertaken. *Id.* at 764, 767. Discon has failed to plead such facts. This failure to specify what "concerted actions these parties took to further their [alleged] goal" requires

dismissal.[3] *Teletronics Proprietary Ltd. v. Medtronic, Inc.,* 687 F. Supp. 832, 837 (S.D.N.Y. 1988); *see also Eastway Const. Corp. v. City of New York,* 762 F.2d 243, 250 (2d Cir. 1985).

Discon attempts to bolster its conclusory allegations of a conspiracy by claiming that it is the victim of precisely the sort of anticompetitive conduct that led to the break up of AT&T. That argument, however, only confirms the vast breadth of the factual controversy Discon seeks to incite with this action and underscores the need for a fair level of coherent detail in Discon's Complaint. Indeed, Discon endeavors to relitigate much of the conduct underlying the break up of old AT&T. Defendants should not be put to the expense of such a large antitrust action absent a well pleaded cause of action. *See Associated Gen. Contractors of California, Inc. v. California State Council of Carpenters,* 459 U.S. 519, 528 n.17 (1983) ("[A] district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed."). Unless Discon comes to grip with the law it seeks to apply and interposes a plain statement of its claims, this action will not survive.[4]

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[3] Because N.Y. Gen. Bus. Law § 340 *et. seq.* ("Donnelley Act") generally conforms and is interpreted in the same manner as the Sherman Act, *Anheuser Busch v. Abrams,* 71 N.Y.2d 327, 525 N.Y.S.2d 816 (1988), the Eighth Count of the Complaint is dismissed for the reasons stated here.

[4] Defendants' challenge to Discon's standing—which is founded on the tautology that Discon alleges no antitrust injury because it alleges no antitrust violation—need not be addressed. Further, the Court need not reach defendants' argument that Discon's § 1 claim fails because it does not allege a relevant market. *See Image Technical Servs., Inc. v. Eastman Kodak Co.,* 903 F.2d 612 (9th Cir. 1990), *aff'd,* 1992 WL 119156 (U.S. June 8, 1992) (whether single product parts and services can constitute relevant market for a § 1 tying claim).

C. *Monopoly Claims*

Section 2 of the Sherman Act provides that: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ." 15 U.S.C. § 2. The Second Count of the Complaint purports to allege that defendants monopolized and attempted to monopolize the market of network services in New York State and contiguous areas. Complaint ¶ 133. The Third Count of the Complaint purports to allege that defendants conspired amongst themselves and with others to monopolize the market for network services in New York State. Complaint ¶ 139. The Court addresses these theories *seriatim*.

1. *Monopoly*

The elements of monopolization under § 2 are: "(1) the possession of monopoly power in the relevant market; and (2) the willful acquisition or maintenance of that power, as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Volvo N. Am. Corp. v. Men's Int'l Professional Tennis Council*, 857 F.2d 55, 73 (2d Cir.), *cert. denied*, 487 U.S. 1219 (1988) (citations omitted). In its Complaint, Discon alleges that:

> NYNEX Corp. and MECo attempted to monopolize, and did monopolize, markets for network services in New York State and in contiguous areas. NYNEX and MECo effectively controlled the price at which contracts for network services were obtained. NYNEX and MECo acquired and maintained power to restrict or eliminate competition in this market.

Complaint ¶ 133. Discon fails to state a claim for monopolization, however, because defendants do not participate

as competitors in the same market as Discon. *See FLM Collision Parts, Inc. v. Ford Motor Co.*, 543 F.2d 1019, 1030 (2d Cir. 1976) (§ 2 claim dismissed because defendant did not compete in relevant market), *cert. denied*, 429 U.S. 1097 (1977). Neither NYNEX nor MECo are competitors in the market of suppliers. MECo buys network services, while Discon sells network services. The Complaint admits that MECo purchased network services for New York Telephone, Complaint ¶¶ 13, 51, 61, and that MECo is the purchasing arm of NYNEX and New York Telephone. Complaint ¶ 13. NYNEX and MECo, therefore, cannot be liable for monopolizing a business in which they do not compete. *See Official Airlines Guides, Inc. v. FTC*, 630 F.2d 920, 926 (2d Cir. 1980) (rejecting monopolization claim because defendant "is engaged in a different line of commerce" than the market allegedly affected), *cert. denied*, 450 U.S. 917 (1981); *FLM Collision Parts, Inc.*, 543 F.2d at 1030; *Addino v. Genesee Valley Medical Care, Inc.*, 593 F. Supp. 892, 901 (W.D.N.Y. 1984) (alternative ground for dismissal of § 2 claim was that defendant was not a competitor of plaintiffs); *see also White v. Rockingham Radiologists, Ltd.*, 820 F.2d 98, 104-05 (4th Cir. 1987) (hospital and plaintiff neurologist did not compete); *Mercy Peninsula Ambulance, Inc. v. County of San Mateo*, 791 F.2d 755, 759 (9th Cir. 1986) (rejecting ambulance company's challenge to county's award of exclusive contract to competitor because county was not a competitor in the market for healthcare provision). Thus, Discon's § 2 monopolization claim is dismissed.

2. *Attempted Monopolization*

The Second Count of the Complaint also purports to allege that defendants attempted to monopolize the market for network services in New York State. Complaint ¶ 133. There are three elements in an attempted monopolization claim: "(1) anticompetitive or exclusionary conduct; (2) specific intent to monopolize; and (3) a dangerous

probability that the attempt will succeed." *Volvo N. Am. Corp.*, 857 F.2d at 73-74 (citations omitted). Discon's Complaint does not allege specific intent. Complaint ¶¶ 132-137. Specific intent to monopolize is a necessary element of a claim based on attempt to monopolize, *id.*, and generalized allegations of intent are insufficient. *Cf. United States v. Consolidated Laundries Corp.*, 291 F.2d 563, 572 (2d Cir. 1961); *Blaine v. Meineke Discount Muffler Shops, Inc.*, 670 F. Supp. 1107, 1110-11 (D. Conn. 1987). Accordingly, Discon's attempted monopolization claim must be dismissed.

Moreover, to allege a dangerous probability of success of an attempt to monopolize, Discon must allege market power. *See Twin Laboratories, Inc. v. Weider Health & Fitness, Inc.*, 900 F.2d 566, 570 (2d Cir. 1990). As stated previously, defendants do not compete in the same market as Discon. As the court stated in *Capital Imaging Assoc. P.C. v. Mohawk Valley Medical Assoc.*, 725 F. Supp. 669 (N.D.N.Y. 1989):

> It is clear to this court that plaintiff and defendants are not competitors. Plaintiff is in the business of selling radiological services; defendants are not. . . . Not only is there no *dangerous probability* that defendants will succeed in monopolizing the markets identified by plaintiff, there is no present *possibility* defendants wll do so.

Id. at 678 (emphasis in original); *see also International Distribution Centers, Inc.*, 812 F.2d at 790-91; *Nifty Foods Corp.*, 614 F.2d at 841; *Soap Opera Now, Inc. v. Network Publishing Corp.*, 737 F. Supp. 1338, 1347 n.12 (S.D.N.Y. 1990); *Theater Party Assoc. v. Shubert Org.*, 695 F. Supp. 150, 156 (S.D.N.Y. 1988). Thus, because Discon fails to adequately allege a dangerous probability that defendants would succeed in attempting to monopolize network services in New York State, its attempt to monopolize claim must be dismissed.

3. *Conspiracy to Monopolize*

The Third Count of the Complaint purports to allege that defendants conspired amongst themselves and with others to monopolize the market for network services in New York State. Complaint ¶¶ 138-140. The elements of a conspiracy to monopolize claim are: "(1) concerted action, (2) overts acts in furtherance of the conspiracy, and (3) specific intent to monopolize." *Volvo N. Am. Corp.*, 857 F.2d at 74. Discon fails to allege any concerted action, whatsoever. Further, it fails to allege specific intent to monopolize. "Although the Federal Rules permit statement of ultimate facts, a bare bones statement of conspiracy or of injury under the antitrust laws without any supporting facts permits dismissal." *Heart Disease Research Found. v. General Motors Corp.*, 463 F.2d 98, 100 (2d Cir. 1972). In the end, Discon's conspiracy claim amounts to nothing more than allegations of a joint decision by NYNEX, New York Telephone and MECo to buy from Technologies and not from Discon. Under *Copperweld*, such intracorporate conduct simply does not violate the Sherman Act. *See City of Mount Pleasant, Iowa v. Associated Elec. Coop., Inc.*, 838 F.2d 268, 274 (8th Cir. 1988).

D. *RICO Claims*

In the Fourth, Fifth, Sixth and Seventh Counts of the Complaint, Discon claims that defendants are liable under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* ("RICO"). Complaint ¶¶ 141-57. RICO provides a civil remedy for any person "injured in his business or property by reasons of a violation of § 1962 of this chapter. . ." 18 U.S.C. § 1964(c). Section 1962, in turn, is divided into four subsections each of which sets out a separate type of prohibited activity involving a "pattern of racketeering activity" or the collection of an unlawful debt. 18 U.S.C. § 1962. "Racketeering activity" is defined in the statute to include various federal and state criminal law offenses such as mail fraud,

wire fraud, fraud in the sale of securities, extortion and obstruction of justice. 18 U.S.C. § 1961(1). A "pattern of racketeering activity" consists of at least two predicate acts violating the criminal statutes listed in § 1961(1) within ten years of the claim, where the acts were related and amount to continuing criminal activity, or by their nature pose a likelihood of continuing criminal activity. *H.J. Inc.*, 492 U.S. at 239. Allegations that a defendant has engaged in predicate acts of racketeering activity are necessary prerequisites for stating a claim under any subsection of § 1962.

After carefully reviewing Discon's RICO claims, the Court finds that Discon has failed to plead the predicate acts of mail fraud, wire fraud and fraud in the sale of securities with the particularity required under Fed. R. Civ. P. 9(b) and the allegations in the Complaint regarding these predicate acts must therefore be dismissed. In addition, the Court finds that Discon has failed to allege facts stating a claim under any of the subsections of § 1962. Thus, the Fourth, Fifth, Sixth and Seventh Counts in the Complaint are dismissed.

1. *Pleading Fraud With Particularity Under Rule 9(b)*

Rule 9(b) provides, in pertinent part, that:

> In all averments of fraud . . . the circumstances constituting fraud . . . shall be stated with particularity. Malice, intent, knowledge and other conditions of mind may be averred generally.

"Rule 9(b) is designed to provide the defendant fair notice of the plaintiff's claims, and to enable the defendant to prepare a suitable defense, protect his reputation or good will from harm, and reduce the number of strike suits." *O'Brien v. Price Waterhouse*, 740 F. Supp. 276, 279 (S.D.N.Y. 1990), *aff'd*, 936 F.2d 674 (2d Cir. 1991). Because of the potential harms attendant to being

labelled a racketeer, these aims are even more compelling in civil RICO actions. *See Lou v. Belzberg*, 728 F. Supp. 1010, 1024 (S.D.N.Y. 1990); *Philan Ins. Ltd. v. Frank B. Hall & Co.*, 712 F. Supp. 339, 344 (S.D.N.Y. 1989); *Harrison v. Enventure Capital Group, Inc.*, 666 F. Supp. 473, 478 (W.D.N.Y. 1987).

The Second Circuit has imposed stringent pleading requirements on plaintiffs who make allegations of fraud. "[T]he 'complaint must adequately specify the statements it claims were false or misleading, give particulars as to the respect in which plaintiff[] contend[s] the statements were fraudulent, state when and where the statements were made, and identify those responsible for the statements.'" *McLaughlin v. Arthur Anderson*, No. 91-6184, slip op. at 3214 (2d Cir. Apr. 21, 1992) (quoting *Cosmas v. Hassett*, 886 F.2d 8, 11 (2d Cir. 1989)); *see also DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (plaintiffs must specify the "time, place, speaker and content of the alleged misrepresentations."); *Luce v. Edelstein*, 802 F.2d 49, 54 (2d Cir. 1986). A plaintiff asserting mail fraud also must identify the purpose of the mailing within the defendant's fraudulent scheme. *McLaughlin v. Arthur Anderson*, No. 91-6184, slip op. at 3214 (2d Cir. Apr. 21, 1992) (citations omitted).

Further, the plaintiff must supply a factual basis for allegations of scienter that "give rise to a 'strong inference' that the defendants possessed the requisite fraudulent intent." *Beck v. Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988). The allegations must show a motive and a clear opportunity for committing fraud, or circumstances clearly indicating conscious participation in the fraud. *Beck*, 820 F.2d at 50; *O'Brien v. National Property Analysts Partners*, 719 F. Supp. 222, 226 (S.D.N.Y. 1989).

Where multiple defendants are charged, "the complaint should inform each defendant of the nature of his alleged

participation in the fraud." *DiVittorio*, 822 F.2d at 1247. "[T]he wholesale naming of directors and officers of corporations without any indication of the role of the individual defendants" is not enough. *The Limited, Inc. v. McCrory Corp.*, 645 F. Supp. 1038, 1043 n.10 (S.D.N.Y. 1986). Instead, "specific allegations must be made with respect to each particular individual." *Leslie v. Minson*, 679 F. Supp. 280, 284 (S.D.N.Y. 1988).

Applying these principles to the case at hand, the Court finds that Discon's Complaint fails to plead the predicate acts of mail fraud, wire fraud and fraud in the sale of securities with the requisite particularity.[6]

Discon alleges that the predicate acts of racketeering included mail fraud. Complaint ¶¶ 98-101. Discon's Complaint, however, merely lists letters allegedly sent, and fails entirely to specify what statements were made in the letters, the manner in which the statements in the letters were false or misleading, their connection or relation to the particular defendants, or the purpose of the letters in defendants' fraudulent scheme. Thus, the Complaint fails to allege any predicate act of mail fraud with the requisite particularity. *See McLaughlin v. Arthur Anderson*, No. 91-6184, slip op. at 3214-20 (2d Cir. Apr. 21, 1992); *Harrison*, 666 F. Supp. at 478.

Discon also alleges that the predicate acts of racketeering included wire fraud. Complaint ¶¶ 102-105. Again, however, the Complaint fails to describe any acts with the necessary particularity. The Complaint specifies three telephone calls that were allegedly made in furtherance of defendants' scheme, but fails to allege the contents of any of the calls, how the communications were false or misleading, the relationship of the communications to each of the various defendants, or the purpose of the phone calls in defendants' fraudulent scheme. Thus, the Complaint fails to allege any predicate act of wire fraud with the requisite particularity.

[6] Defendants argue that Rule 9(b) should also be applied to the predicate acts of extortion and obstruction of justice that are alleged in the Complaint. "However, Rule 9(b) applies only to claims of fraud or mistake." *McLaughlin v. Arthur Anderson*, No. 91-6184, slip op. at 3221 (2d Cir. Apr. 21, 1992) (citing *Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 25 (2d Cir. 1990)).

The Complaint further alleges fraud in the sale of securities. Complaint ¶¶ 106-109. It fails, however, to specify any particular statement that was false, any particular document in which a false statement appeared or in which there was a material omission, any reason why the allegedly false statements were fraudulent, any particular security purchased by Discon, or the specific role of each defendant in the alleged fraud. Thus, the Complaint fails to allege any predicate act of fraud in the sale of securities with the requisite particularity.

In sum, because the allegations in the Complaint regarding the predicate acts of mail fraud, wire fraud and fraud in the sale of securities consist of conclusory statements lacking any of the particular details required under Rule 9(b), they must be dismissed.

On January 22, 1991, the Judges of this District adopted a Standing Order applicable to all civil RICO claims filed in the District. If Discon elects to interpose an amended complaint in this action that asserts a RICO claim, it must file a RICO Case Statement in compliance with the January 22, 1991 Standing Order when it files its amended complaint.

Compliance with the Standing Order is not a substitute for a well pleaded claim, however. Discon's counsel has represented to the Court that Discon has gathered evidence supporting all of its allegations. He represented that Discon kept contemporaneous records of defendants' wrongdoing, though of what sort he did not say. He represented that he has affidavits from former employees of defendants, and voluminous records of proceedings before the Public Service Commission. Accordingly, Discon

should be able to allege particular facts supporting its allegations of racketeering. In any case, Discon is cautioned that the Court will not hesitate to dismiss with prejudice a RICO claim in an amended complaint that does not comply with the Rule 9(b) principles of this Circuit.

2. *Section 1962(a) Claim*

The Fourth Count of the Complaint purports to allege that defendants are liable under 18 U.S.C. § 1962(a), which prohibits the investment in an interstate enterprise of income derived from "a pattern of racketeering activity or through collection of an unlawful debt." 18 U.S.C. § 1962(a). "[T]o state a claim for civil damages under § 1962(a), a plaintiff must allege injury from the defendants' investment of racketeering income in an enterprise." *Ouaknine v. MacFarlane*, 897 F.2d 75, 83 (2d Cir. 1990). It is not enough for plaintiff to allege injury from the predicate acts because "the essence of a violation of § 1962(a) is not commission of predicate acts, but investment of racketeering income." *Id; see also Azurite Corp. v. Amster & Co.*, 730 F. Supp. 571, 579 (S.D.N.Y. 1990); *Rhone v. Energy North, Inc.*, No. 91-11996, slip op. (D.Mass. Dec. 27, 1991), 1991 WL 332251.

In the instant case, the injury described in the Complaint is merely that defendants' investment in New York Telephone and MECo enabled those enterprises to pursue the activities alleged as predicate offenses. Complaint ¶¶ 143-146. Discon fails to allege a distinct "investment injury" as required in *Oauknine*. Thus, the § 1962(a) claim must be dismissed for failure to state a claim upon which relief may be granted.

3. *Section 1962(b) Claim*

The Fifth Count of the Complaint purports to allege that NYNEX, MECo and Eckenrode violated 18 U.S.C. § 1962(b) by maintaining an interest in and control of New York Telephone through a pattern of racketeering

activity. Complaint ¶ 148. This claim must be dismissed as time-barred.

In *Agency Holding Corp. v. Malley-Duff & Assoc., Inc.*, 483 U.S. 143, 152 (1987), the Supreme Court held that the four-year statute of limitations of the Clayton Act applies in all civil RICO actions. Section 1962(b) states that it is unlawful to acquire or maintain an interest in, or control of, an enterprise through a pattern of racketeering activity or collection of an unlawful debt. 18 U.S.C. § 1962(b). NYNEX acquired its control or interest in New York Telephone on January 1, 1984 upon the divestiture of old AT&T. Complaint ¶ 23. Since that time, New York Telephone has been a wholly owned subsidiary of NYNEX. Discon's Complaint was not filed until May 25, 1990, more than four years after NYNEX's acquisition of control of New York Telephone. If or when Discon interposes an amended complaint stating a § 1962(b) claim, it must specifically identify predicate acts that occurred within the statute of limitations period that would constitute a violation of § 1962(b).

4. *Section 1962(c) Claim*

In the Sixth Count of the Complaint, Discon purports to allege a claim under 18 U.S.C. § 1962(c). More specifically, it alleges that NYNEX, MECo, Eckenrode and O'Reilly conducted and participated in the affairs of New York Telephone through a pattern of racketeering activity, Complaint ¶ 151, and that NYNEX, Eckenrode and O'Reilly conducted and participated in the affairs of MECo through a pattern of racketeering activity. Complaint ¶ 152.

A RICO plaintiff suing for damages under § 1964(c), based upon a violation of § 1962(c), "only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985). Such a claim must be dismissed

if it does not allege facts showing that damage to plaintiff's business or property was proximately caused by the alleged predicate acts of racketeering activity. *County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1311 (2d Cir. 1990); *Hecht*, 897 F.2d at 23; *Norman v. Niagara Mohawk Power Corp.*, 873 F.2d 634, 636 (2d Cir. 1989); *Birdick v. American Express Co.*, 865 F.2d 527, 529 (2d Cir. 1988); *Sperber v. Boesky*, 849 F.2d 60, 64-65 (2d Cir. 1988). Discon's Complaint fails to allege facts showing that any of the alleged predicate acts proximately caused injury to Discon and, therefore, the § 1962(c) claim must be dismissed.

Defendants also argue that the § 1962(c) claim should be dismissed because Discon fails to allege a RICO "enterprise" distinct from the "persons" allegedly committing the RICO violation. The Court rejects this argument.

To state a claim under § 1962(c), a plaintiff must allege that the "persons" committing the RICO violation were distinct from the "enterprise" conducted unlawfully. *Bennett v. United States Trust Co.*, 770 F.2d 308, 315 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986). In paragraph 151 of the Complaint, Discon alleges that NYNEX, MECo, Eckenrode and O'Reilly were "persons" participating in the affairs of an "enterprise," New York Telephone, through a pattern of racketeering activity. Likewise, in paragraph 152, Discon alleges that NYNEX, Eckenrode and O'Reilly were "persons" participating in the affairs of an "enterprise," MECo, through a pattern of racketeering activity.

Defendants argue that, since NYNEX owns MECo and New York Telephone, Eckenrode is employed by NYNEX, and O'Reilly is employed by MECo, the "persons" and "enterprises" alleged in the Complaint are really all one and the same entity, and the § 1962(c) claim must therefore be dismissed pursuant to *Bennett*. However, while MECo, New York Telephone, Eckenrode and O'Reilly are all either subsidiaries or employees of the same entity,

NYNEX, the Second Circuit has expressly held that a defendant may be a "RICO person and one of a number of members of the RICO 'enterprise.'" *Cullen v. Margiotta*, 811 F.2d 698, 730 (2d Cir.), *cert. denied*, 483 U.S. 1021 (1987). In other words, "[w]here the overlap between the defendants and the alleged RICO enterprise is only partial, a RICO claim may be sustained." *Jacobson v. Cooper*, 882 F.2d 717, 720 (2d Cir. 1989).

The alleged RICO "persons" in this case are NYNEX, MECo, New York Telephone, Eckenrode and O'Reilly. However, the only RICO "enterprises" alleged are MECo and New York Telephone. Thus, there is not a complete identity between the RICO "persons" and the RICO "enterprises." Accordingly, dismissal of the § 1962(c) claim based on a failure to allege a RICO "person" distinct from the RICO "enterprise" is not required.

5. *Section 1962(d) Claim*

The Seventh Count of the Complaint purports to allege that defendants conspired and agreed to violate 18 U.S.C. §§ 1962(a), (b) and (c), in violation of 18 U.S.C. § 1962(d). Complaint ¶ 154-157. This claim must fail, however, for two reasons.

First, Discon's RICO conspiracy claim must be dismissed because "[a] claim cannot be made under § 1962(d) in the absence of a viable claim under § 1962(a), (b) or (c)." *Leonard v. Shearson Lehman/Am. Express, Inc.*, 687 F. Supp. 177, 182 (E.D. Pa. 1988). Since Discon's §§ 1962(a), (b) and (c) claims fail for the reasons explained above, its § 1962(d) claim necessarily must fail.

Second, the Complaint does not specifically allege that the defendants agreed to commit specific predicate acts. "[A] RICO civil conspiracy complaint, at the very least, must allege specifically such an agreement." *Hecht*, 897 F.2d at 25. "Conclusory allegations or bare statements

. . . will not withstand a motion to dismiss . . . ." *First City Nat'l Bank & Trust Co. v. FDIC*, 730 F. Supp. 501, 509 (E.D.N.Y. 1990). "[T]he complaint must allege some factual basis for a finding of conscious agreement among the defendants." *Hecht*, 897 F.2d at 26 n. 4. Discon fails to allege such facts. Thus, its § 1962(d) claim is dismissed.

E. *Consumer Protection Act Claim*

The Ninth Count of the Complaint purports to allege that defendants violated the New York Consumer Protection Act, which is codified in N.Y. Gen. Bus. Law § 349. Complaint ¶¶ 162-165. The essential elements of a claim under the Consumer Protection Act are: (1) that the act or practice complained of was misleading in a material respect, *Geismar v. Abraham & Strauss*, 109 Misc.2d 495, 496, 439 N.Y.S.2d 1005, 1006 (Dist. Ct. Suffolk Co. 1981); (2) that the plaintiff was injured, *McDonald v. North Shore Yacht Sales, Inc.*, 134 Misc.2d 910, 914, 513 N.Y.S.2d 590, 593 (Sup. Ct. Nassau Co. 1987); (3) reliance by the plaintiff upon the alleged misrepresentations to his detriment, *Copeland v. Weyerhaeuser Co.*, 124 A.D.2d 998, 999, 509 N.Y.S.2d 227, 228 (4th Dept. 1986), *appeal dismissed*, 69 N.Y.2d 944, N.Y.S.2d 656 (1987); *Butler v. Caldwell & Cook, Inc.*, 122 A.D.2d 559, 560, 505 N.Y.S.2d 288, 290 (4th Dept. 1986); *Burns v. Volkswagon of Am., Inc.*, 118 Misc.2d 289, 291-92, 460 N.Y.S.2d 410, 413 (Sup. Ct. Monroe Co. 1982), *aff'd*, 97 A.D.2d 977, 468 N.Y.S.2d 1017 (4th Dept. 1983), *appeal dismissed*, 61 N.Y.2d 604, 473 N.Y.S.2d 1025 (1984); and (4) that the practice complained of comes within the intended scope of the statute. *Genesco Entertainment v. Koch*, 593 F. Supp. 743, 751-52 (S.D.N.Y. 1984).

Discon's Complaint fails to plead the necessary element of reliance. *See Copeland*, 124 A.D.2d at 999, 509 N.Y.S.2d 228; *Burns*, 118 Misc.2d at 291-92, 460

N.Y.S.2d at 413. The alleged deceptive practices identified in the Complaint are those described in paragraphs 85 to 90, but the Complaint does not allege that Discon relied upon any of those alleged deceptive practices. The Consumer Protection Act claim is therefore dismissed.

This claim also should be dismissed because the alleged injury does not fall within the scope of the Consumer Protection Act. "The typical violation contemplated by the statute involves an individual consumer who falls victim to misrepresentations made by a seller of consumer goods usually by way of false and misleading advertising." *Genesco Entertainment*, 593 F. Supp. at 751-52. Discon's Consumer Protection Act claim falls entirely outside this area. Discon is a supplier of services, not a consumer, and is alleging a general business or commercial injury. "[T]o extend this remedy [provided by the Consumer Protection Act] to plantiff[] would alter completely the legal duties governing commercial relationships in New York." *Id.* Thus, Discon's Consumer Protection Act claim must be dismissed.

F. *Public Service Law Claim*

The Tenth Count in the Complaint purports to allege a claim under N.Y. Pub. Serv. Law § 93. The essential elements of a claim under § 93 are loss or damage caused by gross negligence or willful misconduct of a telephone company where the defendant has disobeyed a positive command or injunction of the Public Service Commission. N.Y. Pub. Serv. Law § 93. Disobedience of a positive command or injunction of the Commission is a prerequisite to a private right of action under § 93. *See, e.g., Meyerson v. New York Tel. Co.*, 65 Misc.2d 693, 696, 318 N.Y.S.2d 900, 903 (Sup. Ct. Kings Co. 1971); *Leighton v. New York Tel. Co.*, 187 Misc. 132, 134, 61 N.Y.S.2d 112, 114 (Sup. Ct. N.Y. Co. 1946); *Carlson Constr. Co. v. New York Tel. Co.*, 45 Misc.2d, 229, 234, 256 N.Y.S.2d 49, 54 (Sup. Ct. Suffolk Co. 1964). Dis-

con's Public Service Law claim must be dismissed because the Complaint fails to allege or show any disobedience of a positive command or injunction of the Public Service Commission.

Discon alleges that NYNEX caused New York Telephone not to file the MECo supply contract with the Public Service Commission as allegedly required under N.Y. Pub. Serv. Law § 110(3). Complaint ¶ 167. This allegedly caused New York Telephone to make payments to MECo in excess of reasonable costs. Section 110(3), however, "was not written to cover all contracts between a utility and its affiliates but only specific categories of contracts . . . ." *New York Tel. Co. v. Public Serv. Com.*, 72 N.Y.2d 419, 426, 534 N.Y.S.2d 136, 139 (1988). In *General Tel. Co. v. Lundy*, 17 N.Y.2d 373, 378-79, 271 N.Y.S.2d 216, 221 (1966), the New York Court of Appeals determined that supply contracts between telephone companies and their affiliates are not one of the categories covered by § 110(3). Thus, the failure to file the supply contract between New York Telephone and MECo was not a violation of § 110(3) and does not create a private cause of action under § 93.

Discon also alleges that NYNEX and MECo have caused New York Telephone to grant an unreasonable preference to MECo in New York Telephone's procurement of network services in violation of N. Y. Pub. Serv. Law § 91(3). Complaint ¶ 168.[6] However, the anti-discrimination provisions of the Public Service Law only apply to discrimination in the sale of the utilities' regulated services. *See In re City Ice & Fuel Co.*, 260 A.D. 537, 542, 23 N.Y.S.2d 376, 381 (3d Dept. 1940). Here, Discon is trying to apply § 91(3) to the purchase by a utility of another firm's unregulated services. Thus, Discon fails to state a claim under § 91(3).

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[6] Paragraph 168 alleges a violation of N.Y. Pub. Serv. Law § 90(3), but it appears that Discon meant to refer to § 91(3).

G. *Prima Facie Tort Claim*

The Eleventh Count of the Complaint purports to allege that defendants committed a *prima facie* tort. *Prima facie* tort is the infliction of harm, with a singular intention to injure the plaintiff, resulting in special damages, without excuse or justification, by an act or series of acts that would otherwise be lawful. *See Lincoln First Bank of Rochester v. Siegel*, 60 A.D.2d 270, 279, 400 N.Y.S.2d 627, 633 (4th Dept. 1977); *Wegman v. Dairylea Cooperative, Inc.*, 50 A.D.2d 108, 114-15, 376 N.Y.S.2d 728, 735-36 (4th Dept. 1975), *appeal dismissed*, 38 N.Y.2d 918, 382 N.Y.S.2d 979 (1976).

In this case, the Court finds that the Complaint fails to adequately allege facts showing that defendants acted with the sole intention of harming Discon. The Complaint is replete with statements and suggestions that defendants acted with the motive of increasing profits or gaining a business advantage. *See* Complaint ¶¶ 35, 55, 86, 144. "When there are other motives, such as profit, self-interest, or business advantage, there is no recovery under the doctrine of *prima facie* tort." *Marcella v. ARP Films, Inc.*, 778 F.2d 112, 119 (2d Cir. 1985); *see also Roberts v. Pollack*, 92 A.D.2d 440, 447, 461 N.Y.S.2d 272, 276 (1st Dept. 1983); *Squire Records, Inc. v. Vanguard Recording Society, Inc.*, 25 A.D.2d 190, 192, 268 N.Y.S.2d 251, 254 (1st Dept. 1966), *aff'd*, 19 N.Y.2d 797, 279 N.Y.S.2d 737 (1967).

H. *Third-Party Beneficiary Claim*

The Twelfth Count of the Complaint purports to allege a third-party beneficiary claim under a "supply contract" between MECo and New York Telephone. Under New York law, third-parties may enforce contracts only when they are "intended" rather than "incidental" beneficiaries. *Fourth Ocean Putnam Corp. v. Interstate Wrecking Co.*, 66 N.Y.2d 38, 44, 495 N.Y.S.2d 1, 5 (1985); *World Trade Knitting Mills, Inc. v. Lidon Knitting Mills, Inc.*,

154 A.D.2d 99, 103, 551 N.Y.S.2d 930, 933-34 (2d Dept. 1990). "Essential to status as an intended beneficiary . . . is either that 'performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary' or that 'the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.'" *Fourth Ocean Putnam Corp.*, 66 N.Y.2d at 44, 495 N.Y.S.2d at 5 (quoting Restatement (Second) of Contracts § 302 (1981)).

Discon's Complaint fails to allege any facts consistent with a claim that Discon was an intended beneficiary of the contract between MECo and New York Telephone. The Complaint does not allege that New York Telephone owed Discon a money obligation that performance of the MECo-New York Telephone would satisfy. Nor does it allege that New York Telephone and MECo intended the contract to benefit Discon. All the Complaint alleges is that the contract required MECo to supply New York Telephone with a price list for the goods and services that it sells to New York Telephone, and to sell those goods and services to New York Telephone at reasonable prices. Complaint ¶ 177. The provision on price lists does not indicate in any way that Discon was an intended beneficiary. Thus, the third-party beneficiary claim must be dismissed. *See County of Suffolk v. Long Island Lighting Co.*, 728 F.2d 52, 63 (2d Cir. 1984); *Ahn v. Rooney, Pace Inc.*, 624 F. Supp. 368, 371 (S.D.N.Y. 1985); *New York State Energy Research and Development Auth. v. Nuclear Fuel Serv., Inc.*, 561 F. Supp. 954, 979 (W.D.N.Y. 1983).

I. *Breach of Contract Claim* [7]

The Fourteenth Count of the Complaint purports to allege that defendants are liable for breach of the contract

[7] The parties have stipulated to dismissal of the Thirteenth Count of the Complaint entitled "Third Party Beneficiary (Consent Decree)."

specified in paragraph 68 of the Complaint that allowed Discon to provide network services to New York Telephone through MECo. Complaint ¶¶ 191-193. More specifically, Discon alleges that:

> The contract described in paragraph 68 implies a covenant of fair dealing, including implied terms (1) that MECo will not arbitrarily disqualify or retaliate against Discon; (2) that MECo would not rig bids or otherwise discriminate against Discon; and (3) that MECo would not force Discon to perform services outside awarded contracts without compensation.

Complaint ¶ 192.

The Complaint does not specify the purported contract subject, the period it was in effect, or even who the parties were who entered into it. Discon has not quoted any provision of the purported contract and has not annexed it to the Complaint. In fact, it is not even pleaded that any specific provision of the contract was breached.

While Discon alleges that there was an implied covenant of fair dealing, it is not specifically alleged that such a covenant was breached. "In every contract there is an implied covenant of good faith and fair dealing which precludes each party from engaging in conduct that will deprive the other of the benefits of their agreement." *Filner v. Shapiro*, 633 F.2d 139, 143 (2d Cir. 1980). Discon, however, fails to allege that the conduct it complains of has deprived it of any of the benefits to which it was entitled under the terms of the purported contract.

In sum, allegations are lacking both as to the essential terms of the contract and as to the nature of its breach. Thus, the breach of contract claim must be dismissed. *Stephens v. Apostol*, 17 A.D.2d 982, 982, 234 N.Y.S.2d 337, 338 (2d Dept. 1962).

J. *Defamation Claim*

The Fifteenth Count of the Complaint purports to allege that defendants are liable for injury to Discon's reputation because of an allegedly false statement that was made to the Public Service Commission that "Discon did not intend to receive payment for the loan requested by a MECo employee." Complaint ¶ 195. The Complaint alleges that the statement was made by New York Telephone after an investigation by New York Telephone Security in 1985. Complaint ¶ 75. This claim must be dismissed as time-barred. Defamation is subject to a one-year statute of limitations set forth in N.Y. Civ. Prac. L & R. § 215(3). *See Wanamaker v. Columbian Rope Co.*, 713 F. Supp. 533, 545 (N.D.N.Y. 1989). This action was not commenced within one year of the alleged defamatory statement.

In its memorandum submitted in opposition to defendants' motion to dismiss, Discon states that it believes "that [New York Telephone] published the libel repeatedly, particularly during the [Public Service Commission's] 1989 audit of central office removals" and therefore the one-year statute of limitations does not bar the defamation claim. *See* Plaintiff's Opposition to Defendants' Motion to Dismiss at 34. The Complaint, however, fails to allege any publication of the defamatory statement besides that alleged to have occurred in 1985.

K. *Civil Conspiracy Claim*

The tort of civil conspiracy in New York is a derivative claim. *See Dean R. Pelton Co. v. Moundsville Shopping Plaza, Inc.*, 173 A.D.2d 201, 569 N.Y.S.2d 424 (1st Dept. 1991). Thus, although a party may not be liable for conspiracy alone, one may be liable for conspiracy to commit another intentional tort. *See Kashi v. Gratsos*, 790 F.2d 1050, 1055 (2d Cir. 1986). Since all of Discon's other claims have been dismissed, its conspiracy claim necessarily fails.

L. *Failure to Comply with Fed. R. Civ. P. 8(a)*

While defendants did not move for dismissal of the Complaint under Fed. R. Civ. P. 8(a), the Court notes that the Complaint should also be dismissed because it fails to comply with that Rule's requirement that "[a] pleading which sets forth a claim for relief . . . shall contain . . . a short and plain statement of the claim showing that the pleader is entitled to relief . . ." The Complaint lacks any coherent organization and is unduly confusing and lengthy. At the beginning of the Complaint, Discon throws together over one hundred paragraphs of factual allegations. Then, in the remainder of the Complaint, it sets out, in conclusory fashion, its claims. However, none of the factual allegations contained in the beginning of the Complaint are matched to any specific claims. Each claim simply incorporates by reference all the preceding paragraphs. It is not the duty of the defendants or this Court to sift through the Complaint and guess which factual allegations support which claims. Rule 8(a) places the burden squarely upon the plaintiff to clearly and succinctly state its claims. If Discon interposes an amended complaint it must comply with Rule 8(a) or face dismissal of the action and possible sanctions.

II. *Motion for Sanctions*

Defendants have moved for sanctions pursuant to Fed. R. Civ. P. 11. They argue that sanctions are warranted because the complaint is not well-grounded in fact, law, or a reasonable argument for the extension of existing law. The Court denies the motion, without prejudice. If Discon files an amended complaint and defendants determine that Rule 11 sanctions are warranted, they may again move for such sanctions.

CONCLUSION

For the reasons stated, defendants' motion to dismiss the Complaint for failure to state a claim is granted, without prejudice. Discon is granted leave to file an amended complaint by July 31, 1992. If the amended complaint includes a RICO claim, it must be accompanied by a RICO Case Statement pursuant to the Court's January 22, 1991 Standing Order. If an amended complaint is not filed by July 31, 1992, this action will be dismissed with prejudice. Defendants' motion for sanctions is denied, without prejudice.

It is so ordered.

/s/ Richard J. Arcara
HONORABLE RICHARD J. ARCARA
United States District Judge

Dated: June 23, 1992

Amended Complaint, dated July 31, 1992

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK

Civ. 90-0546A

DISCON, INCORPORATED,
Plaintiff
v.

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES, NEW YORK TELEPHONE, ROBERT J. ECKENRODE, BERNARD O'REILLY,
Defendants

JURY TRIAL DEMANDED

FIRST AMENDED COMPLAINT

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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK

Civ. 90-0546A

DISCON, INCORPORATED,
Plaintiff

v.

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES,
NEW YORK TELEPHONE,
ROBERT J. ECKENRODE, BERNARD O'REILLY,
Defendants

JURY TRIAL DEMANDED

Plaintiff, Discon, Incorporated ("Discon"), alleges as follows:

I. NATURE OF THIS ACTION

1. This action responds to a pattern of bidrigging, extortion, and anti-competitive practices by which NYNEX caused New York Telephone ("NYT") to divert regulated funds to unregulated NYNEX affiliates, including NYNEX Materiel Enterprises ("MECo"). Acting in concert with AT&T, NYNEX also restrained trade and monopolized the market for removal services, in which Discon operated.

2. *Monopolization* (Counts One through Three). Prior to divestiture, AT&T extended monopoly power derived from the local telephone monopoly of NYT into markets for the supply of equipment and services used by telephone companies. This violated Section 2 of the Sherman Act, 15 U.S.C. § 2. For example, Western Electric, a subsidiary of AT&T, removed central office equip-

ment that was obsolete. After divestiture, NYNEX, through MECo and NYT, and AT&T, through AT&T Technologies ("Technologies") and AT&T Communications ("AT&T-C"), combined and conspired to perpetuate the monopolization of the market for removal services. NYNEX and AT&T (the antitrust combination) controlled both the supply and demand sides of this market. NYT and AT&T-C continued to be the only major purchasers of removal services in New York State. MECo and Technologies collectively refused to deal with low-cost suppliers, such as Discon, and took concerted action to drive Discon from the market. MECo and AT&T maintained an artificially high price for removal services provided to NYT. The combination divided monopoly profits through a system of markups and rebates. Through NYT and AT&T-C, the horizontal combination passed on the added costs by increasing regulated telephone rates. Their conspiracy also included causing false claims regarding Discon to be made to the New York Public Service Commission ("PSC"). The conspiracy to monopolize, the attempt to monopolize, and the successful monopolization of the market for removal services injured Discon by driving it out of business.

3. *Restraint of Trade* (Count Four). The antitrust combination included concerted action between MECo and Technologies to restrain trade in the market for removal services and other products and services purchased by telephone companies, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. Despite the prohibition on procurement discrimination in the AT&T consent decree, NYNEX required NYT to buy only through MECo, which in turn awarded contracts to AT&T on a preferential or exclusive basis. MECo secretly marked Technologies' price up further (by as much as 42 percent) before billing NYT. Acting in concert with MECo, AT&T agreed not to deal directly with NYT, not to disclose its actual prices to NYT or to regulators, and to provide

rebates to MECo. MECo threatened to retaliate, and did retaliate, against suppliers that disclosed markups to NYT and offered to compete with MECo. These anticompetitive activities injured Discon, as a low-cost supplier of removal services and as a consumer of regulated telephone services.

4. *Conduct of the Affairs of an Enterprise Through a Pattern of Racketeering Activity* (Counts Five and Seven). Defendants conducted and conspired to conduct the affairs of NYNEX (the conduct enterprise) through a pattern of racketeering activity in support of schemes to defraud ratepayers of NYT, in violation of 18 U.S.C. § 1962(c). Each defendant agreed to participate in more than one predicate act of racketeering, which included acts of mail fraud, wire fraud, fraud in the sale of securities, obstruction of justice, obstruction of a criminal investigation, extortion, interstate transportation of stolen goods, and interstate travel in aid of racketeering.

5. *Control of an Enterprise Through a Pattern of Racketeering Activity* (Counts Six and Seven). Defendants maintained and conspired to maintain control of NYT (the controlled enterprise) through a pattern of racketeering, in violation of 18 U.S.C. § 1962(b). Defendants understood that regulators, if they discovered the scheme to defraud NYT ratepayers, would restrict or eliminate defendants' control of NYT. To maintain control of NYT, defendants engaged in acts of extortion wire fraud, mail fraud, obstruction of justice, and obstruction of a criminal investigation, as part of a scheme the purpose of which was to conceal the fraud on NYT's ratepayers from state and federal regulators.

6. Discon also seeks relief under the General Business Law and the common law of New York (Counts Eight through Thirteen).

II. JURISDICTION

7. This case arises under the federal antitrust laws, Title 9 of the Organized Crime Control Act ("RICO"), Article 22 of the New York General Business Law ("Donnelly Act"), and the common law.

8. 15 U.S.C. § 15 (Section 4 of the Clayton Act) confers jurisdiction over Counts One through Four.

9. 18 U.S.C. § 1964 confers jurisdiction over Counts Five through Seven.

10. This Court has pendant jurisdiction over Counts Eight through Thirteen.

III. VENUE

11. Each of the defendants does business in the Western District of New York.

12. 15 U.S.C. 22, 18 U.S.C. § 1965, and 28 U.S.C. § 1391 provide venue in the Western District of New York.

IV. PARTIES

13. Plaintiff Discon is a corporation organized under the laws of the State of New York. Discon's primary business is the provision of "removal services," which constitutes the salvage and disposal of obsolete telephone central office equipment. At times relevant to this complaint, Discon was a customer of NYT, from which Discon obtained telephone services under tariff.

14. Defendant NYNEX Corporation ("NYNEX Corp.") is a holding company incorporated under the laws of Delaware. Its principal place of business is New York City. NYNEX's principal business is the provision of exchange service and exchange access, which it conducts through regulated subsidiaries NYT and New England Telephone & Telegraph ("NET"). NYNEX Corp. has violated the antitrust laws through various subsidiaries, collectively referred to as "NYNEX."

15. Defendant NYT is a New York corporation, which provides exchange telecommunications and exchange access in New York State and adjacent areas of Connecticut. At times relevant to this Complaint, the remaining defendants controlled NYT (the controlled enterprise) through a pattern of racketeering.

16. Defendant MECo was incorporated under the laws of Delaware. NYNEX created MECo as a separate, profit-making venture responsible to the parent holding company. MECo's primary business function is procuring goods and services for NYT and NET, and for NYNEX Service Company ("NSC"), a subsidiary of the regulated telephone companies. In March 1990, the PSC forced NYNEX to transfer the activities of MECo to a wholly-owned subsidiary of NYT and NET. In April 1992, in response to disclosures that Discon and other parties made, the PSC prohibited most transactions between NYT and unregulated affiliates.

17. Defendant Robert J. Eckenrode is a citizen of Connecticut. From 1983 (when he was still an employee of AT&T) until 1986, Eckenrode served as vice president in charge of planning the structure of NYNEX. From 1986 to 1988, he was executive vice president of NYNEX Corp. and oversaw MECo and other unregulated activities. Eckenrode designed the "Eckenrode Synergy Plan," which required NYT officials to divert regulated funds to subsidize unregulated NYNEX affiliates. Eckenrode concealed information regarding the ratepayer frauds and unorthodox business practices at MECo from regulators. In 1988, NYNEX Corp. named him vice chairman. Eckenrode signed a fraudulent report to the Securities and Exchange Commission ("SEC") in March 1990.

18. Defendant Bernard O'Reilly is a citizen of New Jersey. O'Reilly was a district manager of MECo. Through acts of extortion, O'Reilly attempted to induce Discon affirmatively to misrepresent to NYT the terms of contracts between Discon and MECo, to perform work

for MECo without compensation, and to defraud purchasers of scrap that MECo acquired from NYT. O'Reilly transported scrap taken by fraud from NYT across state lines.

19. The NYNEX Family of Companies ("NYNEX") is an enterprise comprised of an association in fact among NYNEX Corp., its subsidiaries (including NYT and MECo), their officers (including Eckenrode), employees (including O'Reilly) and their accountants, attorneys, and other agents. At times relevant to this Complaint, defendants and other persons conducted the affairs of NYNEX (the conduct enterprise) through a pattern of racketeering.

V. BACKGROUND

20. In the face of litigation under the Sherman Act, NYNEX made specific undertakings not to discriminate against unaffiliated suppliers. Despite these commitments, NYNEX discriminated against Discon and monopolized markets for removal services.

21. Until January 1, 1984, AT&T owned the Bell operating companies ("BOCs"), including NYT and NET, as well as Technologies, which manufactured and procured equipment for the BOCs. BOCs obtained a small amount of equipment from unaffiliated suppliers, collectively known as the "general trade." A civil antitrust action, brought by the United States on November 20, 1974, charged that AT&T monopolized various markets in violation of Section 2 of the Sherman Act. The principal claim was that AT&T used the BOCs' natural monopoly over exchange service to discriminate against unaffiliated suppliers and thereby to extend its monopoly power into potentially competitive markets, including the markets for network equipment and removal services. On September 11, 1981, the United States District Court for the District of Columbia found that AT&T "has violated the antitrust laws in a number of ways over a lengthy period of time." *United States v. AT&T*, 524 F. Supp. 1336, 1381 (D.D.C.

1981). Specifically, the Court concluded that "procurement decisions within the Bell System tend to create a predisposition within [BOC] managers in favor of Western profits and against the general trade competition." *Id.* at 1373. On August 11, 1982, this District Court found that "there was proof that AT&T used its control over the local Operating Companies to force them to buy products from Western Electric even though other equipment manufacturers produced better products or products of identical quality at lower prices." 552 F. Supp. 131, 163 (D.D.C. 1982). On August 24, 1982, AT&T entered a consent decree ("consent decree") to settle this litigation. The consent decree required that AT&T divest the BOCs. On January 1, 1984, AT&T transferred two telephone companies (NYT and NET) to NYNEX Corp.

22. The consent decree imposed obligations on NYNEX and other divested BOCs. The consent decree required the BOCs to provide equal access to interexchange carriers, which resulted in a large number of removals and installations of exchange central offices. It prohibited the BOCs from discriminating between AT&T and others in the procurement of products and services, and required them to submit procurement procedures to Justice. The AT&T consent decree also prohibits a BOC from discriminating in favor of its own affiliates.

23. Despite divestiture, NYT remains the dominant exchange carrier in New York State. Except for Rochester, Jamestown and Middletown, NYT serves every town and city in the State whose population exceeds 25,000. As of December 31, 1989, NYT served 89.9 percent of all network access lines in the State. In these areas, NYT supplies more than 95 percent of exchange service and exchange access. NYT continues to have market power and the ability to extend that power into markets for the supply of products and services that telephone companies require.

24. AT&T created MECo prior to divestiture and caused NYT and MECo to enter into an agreement dated December 30, 1983 ("MECo Supply Contract") that purported to make "available to [NYT] a procurement entity which is established, organized, staffed, and equipped to purchase products and . . . services . . . so as to achieve economies and other increased efficiencies." The agreement required MECo to maintain reasonable prices and to include them "insofar as practicable [in] published price lists." NYT specifically intended the maintenance of "published price lists" to benefit third-party vendors, such as Discon, by encouraging them to offer services to NYT through MECo where they could undercut existing prices, many of which AT&T had set when Western Electric was the monopoly supplier.

25. On January 1, 1984, AT&T transferred control of MECo to NYNEX Corp. AT&T failed to comply with the consent decree, which required that MECo receive "sufficient facilities, personnel [and] systems . . . to perform independently of AT&T." MECo lacked the staffing and expertise to conduct effective procurement on a competitive and independent basis. It continued to collude with, cooperate with and depend upon AT&T and Technologies. Even after divestiture, MECo awarded Technologies contracts on a preferential basis, charging administered prices into NYT's ratebase and regulated expense accounts.

VI. MONOPOLIZATION OF REMOVAL SERVICES MARKET

A. Extension of Market Power Into Removal Services Market

26. Technologies is the dominant supplier of removal services in New York State. Prior to divestiture, Western Electric, Technologies' predecessor, performed virtually all removals at NYT's exchange central offices. Technologies continues to be the exclusive supplier of removal

services to AT&T-C, which operates an interexchange network in the State. Acting in concert with MECo, Technologies has perpetuated its monopoly over the supply of removal services to NYT.

27. After divestiture, most BOCs other than NYT and NET decided to rely on unaffiliated contractors for removals (or use employees whose wages are charged directly into regulated accounts). Of more than 400 removals, NYT only did four, and only administered bids for approximately forty. NYT contracted with MECo for the remainder. The purpose of this arrangement was to allow NYT to charge excess costs into regulated accounts and to generate profits at MECo, which was not subject to effective regulation.

28. The consent decree required NYT to provide equal access to inter-exchange service. This forced NYT to remove substantial parts of most central offices and to install new electronic switches. NYT's network service requirements have been approximately $50 million per year since divestiture.

29. As a result, NYT and AT&T-C are the dominant purchasers of removal services in the New York State area. At times relevant to this complaint, MECo and Technologies were also the dominant suppliers of removal services in the New York State area. NYNEX and AT&T created a horizontal combination whose object was to exclude new entrants from the monopolized market for removal services, to maintain high price levels in this market, and to recover these administered prices through regulated rates for telephone service.

30. The PSC and FCC have both found that MECo procured on a noncompetitive basis and increased costs subject to regulation. As found by the PSC staff, "MECo's early central office equipment removal jobs demonstrated poor service to NYT and highlighted MECo's lack of experience. . . . MECo's management actually did lead to inconsistent and unfair treatment of vendors." The PSC

staff concluded that MECo's improper awards of removal contracts cost NYT at least $20 million from 1984 to 1988. As found by the FCC, "MECo overcharged its regulated affiliates on sales of products and services, and the regulated telephone companies in turn, passed on excessive costs to ratepayers by improperly recording the overcharges 'above the line' as regulated costs." *New York Telephone* ("*NYT*"), FCC 90-57, para. 16. "Notwithstanding inconsistent statements in [materials filed with the FCC], markups had a wide and inconsistent range with no discernible relationship to costs." *id.*, para. 18. At least until March 16, 1990, NYNEX used MECo to inflate the costs that NYT recovered under state and federal tariffs and to generate unregulated profits that MECo sent to NYNEX Corp. as dividends.

31. MECo and Technologies combined to set the price for removal services in New York State. MECo agreed to award Technologies most contracts on a non-competitive basis. MECo allowed Technologies to write job change orders (or "JIMs") to increase payments on NYT contracts in excess of the not-to-exceed price. In return for these concessions, Technologies agreed to serve only as a subcontractor to MECo on most contracts. This allowed MECo to mark up Technologies' prices. Acting in concert, Technologies and MECo used markups and rebates to divide monopoly profits derived from the sale of removal services to NYT at the inflated prices that they set.

B. Exclusion of Discon

32. MECo used monopoly power unlawfully extended into the market for removal services to exclude Discon from competition.

33. NYNEX and AT&T combined to exclude Discon from the market for removal services. Circumstances exclude the possibility that NYNEX affiliates acted unilaterally in deciding that NYT would not obtain removal services from Discon, but would obtain removal services from Technologies. These facts include:

(a) AT&T conspired with Robert McGee, a Buffalo subcontractor, and NYNEX personnel to provide false information that would supply a basis to defend the decertification of Discon to state and federal regulators. (*see* paragraph 47)

(b) The division of monopoly profits derived from sales of removal services to NYT was part of a package of reciprocal arrangements between NYNEX and AT&T including the secret year-end rebate, the high technologies contract, and the plug-in contract described in paragraphs 61 and 63 below.

(c) NYT and AT&T agreed to assign to Technologies supervisory and quality control responsibilities relating to contracts awarded to Discon.

(d) NYNEX and AT&T agreed that Technologies would use preferential billing systems and could use job change orders to receive payments in excess of Technologies' fixed-price bid.

(e) Prior to divestiture, AT&T placed NYNEX in control of executives, including Lawrence Friedman, head of MECo purchasing, and Eckenrode, that were committed to perpetuating de facto integration of AT&T and NYNEX and continuing the anticompetitive practices that gave rise to the divestiture.

(f) In violation of the consent decree, AT&T failed to transfer to MECo the staffing and expertise necessary to conduct effective procurement on a competitive and independent basis.

(g) Agents of AT&T (and of a rigging company that worked with AT&T on removals projects) entertained NYNEX procurement personnel at meetings in Florida. MECo, through Friedman, arranged these meetings and invited the participants. MECo favored

vendors, including AT&T and the rigging company, that attended these meetings.

34. NYNEX and AT&T agreed that MECo would reassign removal contracts, including those at Otego, Hobart and Nichols, to Technologies even though NYT had already awarded the jobs to Discon at a lower price. The PSC staff found fourteen additional instances where Technologies received removal contracts when it was not the lowest bidder.

35. In order to exclude Discon from the market, NYNEX and Technologies agreed that NYT would discriminate against Discon and in favor of AT&T by allowing Technologies access to its "725" prepaid billing system. This provided for payment one month in advance of work performed. Discon's payments, by contrast, were irregular and delayed by as much as a year after performance.

36. In order to exclude Discon from the market, NYNEX and AT&T agreed to assign to Technologies supervisory and quality control responsibilities relating to contracts awarded to Discon.

37. MECo further discriminated against Discon and in favor of AT&T by refusing to provide written contracts or authorizations for three jobs, whose value exceeded a million dollars. Because this practice violated standard procurement procedures, O'Reilly demanded that Faltisco tell NYT personnel that Discon had received countersigned copies of its offers.

38. MECo forced Discon to accept obligations outside its contract, to forgo billing job changes and to dispose of scrap on non-economic terms. The purpose of these changes was to enhance MECo's profits and conceal losses caused by errors and irregularities in MECo's administration of contracts. These burdens discriminated against Discon and in favor of AT&T because O'Reilly did not impose similar requirements or make similar threats

against Technologies. O'Reilly threatened to retaliate against Discon and to place Discon out of business if it did not absorb the costs added by these changes.

39. Technologies used JIMs or charged extra hours on non-competitive jobs to build up a reserve to subsidize predatory pricing on jobs that were open to competitors. In connection with the removal of a 4A and tandem switch at the central office on Franklin Street in Buffalo, Technologies calculated a bid price of $1.7 million. In an attempt to undercut Discon, Technologies bid $998,000, which was below its actual costs.

40. On June 18, 1984, Discon submitted a bid to MECo for $574,000 for the Franklin Street removal and won the contract. Without the knowledge of Discon or of NYT managers, MECo marked this up by 45 percent to $832,000. MECo sent NYT documentation in which Technologies' actual bid had been covertly marked up by the same percentage.

41. On July 17, 1984, Discon performed an emergency re-use removal in Chappaqua at the request of NYT Engineering. NYT told Discon that they were unable to reach anyone at MECo in a timely manner. O'Reilly upbraided Discon for dealing directly with NYT and particularly for disclosing the price of the removal, which threatened MECo's future ability to pass on undisclosed markups.

42. In mid-August 1984, NYT asked Discon to perform an emergency cable-mining job at Franklin Street, Buffalo. Discon was unable to reach anyone at MECo to discuss the request. Discon agreed to do the job for $1,000, which was far below the rates that MECo had been charging NYT for similar work performed by Discon. O'Reilly again upbraided Discon for working directly for NYT. He stated that NYNEX policy prohibited vendors from disclosing their prices to NYT.

43. In late October 1984, a NYT engineer told Faltisco that Technologies was complaining that Discon was awarded Franklin Street only because MECo had not marked up the Discon price as much as the Technologies price. As a result, Faltisco met with John Jacoy, a NYT manager, and disclosed Discon's actual price. At this time, Jacoy learned that MECo had marked up Discon's price by 45 percent. Jacoy later found that there were markups of up to 600 percent on other jobs that MECo had assigned to Discon. In early November 1984, Jacoy asked Discon to perform another emergency removal. Discon agreed to do the job for $20 per hour. This was substantially below Technologies' rate.

44. During November 1984, NYT requested that Discon submit a bid for a removal in Williamsville. Two days before the bid was due, O'Reilly caused Robert Zirkelbach of MECo to fly to Buffalo and to demand that Discon notify NYT that it would not bid. O'Reilly told Faltisco that unless he signed the letter delivered by Zirkelbach, MECo would put Discon "out of business." The letter stated that Discon was only "prepared to accept orders [placed through MECo] pursuant to our existing contract agreement." Zirkelbach also delivered a contract backdated to November 1, 1984, which allowed Discon to provide removal services to NYT through MECo. Zirkelbach represented that Discon should anticipate that MECo would ask it to bid on all network service projects that MECo administered. He told Faltisco that he had better prepare for Discon to "grow like hell."

45. A NYT manager telephoned Faltisco on the due date and told him that unless Discon bid on Williamsville and agreed to work directly with NYT, he would see to it that Discon never worked for NYT in the mid-Hudson region. Subsequently, both NYT and MECo excluded Discon from all requests for proposals in the mid-Hudson region.

46. Technologies agreed to do the Williamsville removal for the firm price of about $20,000. Technologies failed to complete the removal, even after submitting additional billings (JIMs) for $40,000. NYT made these additional payments over Jacoy's objection.

47. On November 27, 1984, NYT substantially expanded Discon's role in cable-mining at Franklin Street. The following day, NYNEX and Technology caused Robert McGee, a former partner of Faltisco, to send a letter to NYNEX Corp. making false statements regarding Discon. Among the false statements were (1) that Discon was not incorporated, (2) that Lepkowski of NYT had favored Discon by guaranteeing a contract between Discon and Rupp Rental, (3) that Discon damaged cables and that NYT personnel repaired them at no cost, (4) that NYT provided training and dismantling assistance to Discon, (5) that Discon had committed "theft" of precious metals during the job. Although McGee described himself as a competitor of Discon, he submitted no bids except jointly with Technologies. MECo, through agents of NYT Security who knew the allegations to be false, subsequently used the letter as an essential part of the scheme to defraud NYT ratepayers by excluding Discon as a supplier. To reward MeGee, AT&T subcontracted McGee on removal contracts.

48. Effective January 1, 1985, Discon and MECo entered a general supply contract for a term of three years. The contract provided that MECo "shall pay [Discon] for the performance of services under this Agreement . . . within a reasonable time." The contract included an oral term that Discon would be allowed to bid on all removal service contracts that MECo managed. Exhibit 1 to this complaint is a true copy of the written portion of this contract. MECo never provided the written notice necessary to terminate this contract.

49. In March 29, 1985, O'Reilly falsely told Faltisco by telephone that NYT had closed billing for Franklin

Street, when in fact NYT had instructed O'Reilly to accept billing for extra work that Discon had performed. Discon did not receive any portion of more than $120,000 in invoices prior to December 1989.

50. On June 19, 1985, two employees of NYT Security visited Faltisco. They threatened to make an unfavorable report about Discon unless Faltisco made a statement that Zirkelbach had extorted money from him. Faltisco declined to make the statement because it was untrue. On July 9, 1985, MECo demanded and received Zirkelbach's resignation. In an effort during 1989 to defame and discredit Discon, NYT falsely told the PSC that Discon had made Zirkelbach a loan that Discon did not expect Zirkelbach to repay.

51. In July 1985, Peter Haynes replaced Paul O'Brien as president of MECo. In response to continued objections by NYT, Haynes agreed to discontinue the use of the extreme markups that MECo had used to increase the bids by low-cost vendors to the historic Western Electric price. (The mark up schedules had allowed MECo to inflate Discon's bids by as much as 1004 percent on certain removals.) MECo continued to mark up removals by about 30 percent. This change meant that, after mid-1985, MECo increased its profits by using high-cost vendors (such as Technologies), rather than Discon.

52. During the second half of 1985, Discon performed numerous removal jobs directly for NYT in the Upstate area. During the first half of 1986, Discon performed about fifteen removals for NYT. In most of these cases, Discon received payment within two months. In March 1986, NYT invited Discon to bid on the removal of equipment from its Cortland central office. Discon delivered a sealed, firm price bid the day before the response date. A week later, NYT returned the bid unopened stating that NYT had decided to have MECo handle the bidding.

53. In March 1986, Discon hired Zirkelbach to help on proposed work for Rochester Telephone Company and BellSouth Services, Inc. On May 29, 1986, an employee of NYT Security asked Faltisco if he had hired Zirkelbach and then told Faltisco that he was instructed to state that Discon would not be allowed to perform removals for eighteen months to two years. The following day, the employee stated that he was writing a strong recommendation that Discon be restored to the approved vendor list. The employee also agreed to supply a written copy of NYT's procurement policies.

54. On June 10, 1986, another employee of NYT Security again told Faltisco that he would not be allowed to work for MECo or NYT for a year to eighteen months. No written reason was given. NYT personnel refused to meet with Faltisco to explain the action.

55. Since at least June 1986, the improper decertification of Discon as an approved vendor for MECo or NYT and the refusal to allow Discon to submit bids has restrained Discon from competing in markets for removal services and injured it in its business.

56. On September 8, 1986, a MECo employee told Faltisco that he would not be allowed to work for MECo or NYT until he signed a release and returned evidence of the illegal markups and of incidents of discrimination in favor of Technologies.

57. Persistent efforts by Jacoy and his superior to regain control over removals contracting were not successful. William C. Ferguson, then president of NYT and now chairman of NYNEX Corp., suppressed NYT's efforts to reduce its costs. He ordered NYT personnel to conduct all purchasing through MECo, unless they could fully document the grounds for an "exception" and obtain high-level approval. NYNEX Corp., MECo and Eckenrode caused NYT to publish Methodsgram issue no. 182 in October 1984, which directed NYT to allow MECo to

act as general contractor on all removals contracts. Ferguson reaffirmed this policy in February 1986 and gave complete control over removals to MECo in the Upstate area.

58. It was not until May 1988, after an audit by the PSC, top management directed NYT to contract directly with vendors in all removals. By this time, Discon had laid off all its employees and was no longer doing business.

VII. CONCERTED ACTION BETWEEN NYNEX AND AT&T TO RESTRAIN TRADE IN SERVICE AND EQUIPMENT MARKETS

59. Even in markets (such as personal computers and circuit boards) that they could not monopolize, NYNEX and AT&T combined to restrain trade by causing NYT to buy AT&T products and services on a preferential or exclusive basis, to pay AT&T (through MECo) inflated prices for these products and services, and to recover the resulting excess costs from NYT's regulated ratepayers. In order to divide the excess payments made by NYT's ratepayers, NYNEX and AT&T entered an arrangement whereby (a) MECo would mark up the price of AT&T products and services and prevent NYT from buying low-cost alternatives, (b) MECo would pay excess prices to AT&T for products and services to be included in NYT's ratebase, and (c) AT&T would provide year-end rebates to MECo.

60. Employees of NYT who concluded that there was a cost advantage to purchasing from a source other than MECo were required to submit full documentation for review by superiors. Such employees were accused of not promoting "corporate synergy." They suffered adverse personnel evaluations. As found by the FCC, "NYNEX's corporate purchasing policy, which required [NYT and NET] to purchase certain product lines and services through MECo in most instances, contributed to and reinforced MECo's pricing strategy." *NYT*, para. 18.

61. In December 1984, MECo, through Friedman, and Technologies signed the "high technologies" contract no. X-00105-D. MECo agrees that NYT and NET will buy assured quantities of regulated switching and transmission equipment over a three-year period. AT&T agreed to deal with NYT only through MECo and to give MECo secret rebates directly related to the amount of purchases NYT and NET made.

62. From 1987 to 1990, MECo bought computers from the NYNEX Business Center of NYNEX Business Information Systems ("BISC"), another unregulated NYNEX subsidiary, for resale to NYT. MECo discriminated against unaffiliated suppliers by providing BISC information regarding competitors' offers and allowing it to meet the price. On additional occasions, MECo paid BISC in excess of the price at which computers were available from unaffiliated suppliers.

63. MECo also entered into a contract with AT&T to manage the decline in NYT's purchases of AT&T plug-in circuit boards. Because alternative suppliers produced lower priced circuit boards that were equal or superior in quality, the contract required NYNEX to discriminate in favor of AT&T. When a MECo employee complained that this undertaking violated the consent decree, AT&T threatened him with retaliation. Acting in concert with AT&T, MECo, through Friedman, did retaliate against the employee. Friedman fraudulently altered the employee's personnel records. In January 1988, NYNEX Corp. and MECo caused payments to be made to this employee in settlement of a civil action. A condition of the settlement prohibited the former employee from disclosing allegations to any person, including criminal investigators.

VIII. THE SCHEMES TO DEFRAUD RATEPAYERS

64. The purpose and effect of the overcharges and exclusions of vendors described in paragraphs 32 through 58 was to defraud Discon and other ratepayers by causing

NYT to record overcharges as costs in its regulated accounts. The FCC and PSC relied on NYT's accounts and other regulatory disclosures in approving NYT's rates and practices, in failing to investigate these rates, and in allowing them to continue. By inflating NYT's regulated expense and capital accounts, these overcharges enabled NYT to charge rates for local telephone service and exchange access that exceeded the rates that it could maintain in the absence of the scheme to defraud.

A. MECo Overcharges

65. NYT, which the other defendants controlled, paid MECo overcharges in knowing violation of its obligations under the Public Service Law. From the middle of 1988, NYT began to use separate accounts to record its estimates of illegal overcharges by MECo. In December 1988, MECo agreed to a partial refund of $42.2 million relating to intrastate overcharges. This did not include any overcharges from 1984 through 1987.

66. The FCC determined that MECo's conduct from January 1, 1984 to January 1, 1988 was inconsistent with its rules, 47 C.F.R. 31.01-2(c) and tentatively concluded that NYT's purchase of goods and services from MECo at inflated prices constituted an unreasonable practice in violation of Section 201(b) of the Communications Act of 1934, 47 U.S.C. 201(b). NYT agreed to pay the largest fine in the history of the FCC and to make partial refunds and partial adjustments to its ratebase.

67. The FCC found that MECo had retained excess profits from the overcharges in an amount exceeding $118 million. NYT paid additional excess costs to MECo that MECo diverted to AT&T by paying Technologies more than the market price.

68. The transactions between MECo and BISC described in paragraph 62 allowed MECo to transfer excess profits to BISC in anticipation of the FCC audit. The FCC did not reach diverted profits or excess costs associated with MECo's inefficiency, its diversion of profits to BISC and other NYNEX affiliates, and its discrimination in favor of Technologies. As a result, the adjustments and refunds that the FCC ordered fail fully to correct the impact of the Eckenrode Synergy Plan on NYT ratepayers, even within the interstate jurisdiction. NYT ratepayers have not received refunds associated with these costs, nor has NYT's ratebase been adjusted to remove the resulting inflation of capital assets.

69. NYNEX Corp. and Eckenrode caused NYT to make more than $3 million in payments to an attorney (ostensibly for the defense of an action not related to NYT's regulated activities) and to record these payments in its regulated accounts. Upon disclosure of this fraudulent transfer, the PSC directed a refund of amounts known to have been diverted from intrastate regulated accounts. The FCC has not yet required the restitution of charges made to the interstate jurisdiction.

70. Ratebase adjustments and refunds that the PSC and FCC have required do not fully compensate Discon and other NYT ratepayers for the frauds that defendants committed through NYT from 1984 until 1990. The New York State Department of Law has petitioned for appellate review of the FCC's decision on the basis that the ratebase adjustments are so inadequate as to be arbitrary and capricious.

B. Bid-Rigging and Procurement Discrimination

71. NYNEX Corp., MECo and O'Reilly defrauded NYT ratepayers by rigging bids on removal projects, as described in paragraphs 31, 34, 37, 44, 52 and 54, and by causing the regulated accounts of NYT to bear the resulting excess costs.

72. NYNEX Corp., MECo, NYT, Eckenrode and O'Reilly also defrauded NYT ratepayers by procuring (a) removal services, (b) switching and transmission equipment, and (c) circuit boards from AT&T on a discrimina-

tory basis, even though NYNEX Corp. had represented to the Department of Justice and to the PSC that its procurement practices were competitive.

73. The scheme to defraud ratepayers included acts of racketeering associated with marking up and processing Discon's invoices. NYT personnel believed that MECo was acting as an agent, for which it had been paid a $9 million fee. When MECo marked up Discon's invoices, it fraudulently represented to NYT that the marked up cost was Discon's actual bid. As indicated below, NYNEX and MECo committed at least 80 acts of mail fraud and 90 acts of wire fraud. In addition, O'Reilly personally committed two acts of mail fraud on November 14, 1984.

Initial date	Description of mail fraud or wire fraud	No. of acts
15 June 1984	Discon mails Franklin Street bid of $574,000, which MECo marks up to $832,000	two mail fraud
25 June 1984	NYT mails MECo letter accepting Discon bid for Franklin St.	mail fraud
28 June 1984	(1) Discon mails invoice no. D84-101 to MECo, which logs the actual amount of $1100 and the mark up to $3089 (or 181 percent); (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo. [In this table, NYNEX specifically includes NYNEX Corp.]	four wire fraud; four mail fraud
28 June 1984	(1) Discon mails invoice no. D84-102 to MECo, which logs actual invoice of $2550 and marks up to $6237 or 145 percent; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits	four wire fraud; four mail fraud

Initial date	Description of mail fraud or wire fraud	No. of acts
	mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	
2 July 1984	(1) Discon mails invoice no. D84-001 to MECo, which logs actual invoice of $50,000 and mark up to $72,500; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
11 July 1984	(1) Discon mails invoice no. 84-107 to MECo, which logs actual invoice and marks it up 250 percent; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
11 July 1984	(1) Discon mails invoice no. D84-108 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud

Initial date	Description of mail fraud or wire fraud	No. of acts
17 July 1984	(1) Discon mails invoice no. D84-103 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
13 August 1984	(1) Discon mails invoice no. 84-002 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
31 August 1984	(1) Discon mails invoice no. D84-003 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
14 September 1984	(1) Discon mails invoice no. D84-004 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check,	four wire fraud; four mail fraud

Initial date	Description of mail fraud or wire fraud	No. of acts
	wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	
22 September 1984	(1) Discon mails invoice no. D84-005 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
7 October 1984	(1) Discon mails invoice no. D84-007 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
19 October 1984	(1) Discon mails invoice no. D84-009 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
2 November 1984	(1) Discon mails invoice no. D84-011 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits	four wire fraud; four mail fraud

Initial date	Description of mail fraud or wire fraud	No. of acts
	mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	
10 November 1984	(1) Discon mails invoice no. D84-012 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
14 November 1984	O'Reilly tells Faltisco that if Discon bids directly to NYT on Williamsville, MECo will remove Discon vendor certification, directs him to mail letters of withdrawals to Myers and to mail copy to O'Reilly	extortion; two mail fraud
19 November 1984	(1) Discon mails invoice no. D84-013 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
28 November 1984	The day after NYT expanded Discon's role at Franklin Street, AT&T and MECo caused Robert McGee, a former partner of Faltisco, to send a letter to NYNEX Corp. Among the false	two mail fraud

Initial date	Description of mail fraud or wire fraud	No. of acts
	statements were (1) that Discon was not incorporated, (2) that Lepkowski of NYT had favored Discon by guaranteeing a contract between Discon and Rupp Rental, (3) that Discon damaged cables and that NYT personnel repaired them at no cost, (4) that NYT provided training and dismantling assistance to Discon, (5) that Discon had committed "theft" of precious metals during the job. MECo, through agents of NYT Security who knew the allegations to be false, used the letter as an essential part of the scheme to defraud NYT ratepayers by excluding Discon as a supplier. McGee writes NYT Security a similar letter on 24 February 1986.	
15 December 1984	(1) Discon mails invoice D84-015 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
14 January 1985	(1) Discon mails invoice no. D84-016 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud

Initial date	Description of mail fraud or wire fraud	No. of acts
11 February 1985	(1) Discon mails invoice no. D84-017 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
4 April 1985	O'Reilly, having received Discon bid of $16,500, directs Rice to mark up amount to $49,000, processed as above	four wire fraud; four mail fraud
27 August 1985	(1) Discon mails invoice no. D84-018 to MECo, which logs actual cost and mark up; (2) MECo wires to NYNEX Boston; (3) NYNEX Boston debits mark up price to NYT Albany by wire; (4) NYNEX Boston mails check to Discon; (5) NYNEX credits excess to MECo; (6) Discon deposits check, wires debit to Boston; (7) Discon bank mails check to NYNEX bank; (8) NYNEX bank mails to MECo	four wire fraud; four mail fraud
8 October 1985	NYT mails Hertel Ave. request for quotation to Discon, awards to Discon on 27 November 1985; on Dec. 10, 1985, NYT mails notice that awarded to another firm; processes AT&T invoices by mail and wire	four wire fraud; seven mail fraud

Defendants control additional information regarding the dates on which the individual acts of racketeering associated with each invoice occurred.

C. Theft of Scrap

74. MECo and O'Reilly defrauded purchasers of scrap belong to NYT. O'Reilly sold scrap from NYT central offices to various dealers, including AMAX Copper ("AMAX"). In late September 1984, O'Reilly instructed Discon by telephone to "salt" scrap at Franklin Street by placing higher grade switches on top. Discon did so, but refused to deny that certain scrap had already been removed. The district manager said that Discon would "pay" for its failure affirmatively to misrepresent the truth to AMAX.

75. On or about November 2, 1984, O'Reilly directed Faltisco by telephone to remove wire spring relays from scrap sold to AMAX. O'Reilly warned Faltisco that he would put Discon "out of business" if it did not comply. MECo and O'Reilly also refused to pay Discon for the removal of these wire springs.

76. On or about January 18, 1985, O'Reilly stole high-value items from NYT scrap at Franklin Street. O'Reilly caused Evergreen Trucking to ship two containers weighing 77,415 pounds to 62 Poplar Drive, Morris Plains, New Jersey and from New Jersey to Taiwan.

77. MECo committed at least five act acts of extortion against Discon, as described in paragraphs 38, 50, 56, 74 and 75. NYT joined in the act of extortion described in paragraph 50. O'Reilly committed the acts of extortion described in paragraphs 38, 74 and 75. NYNEX Corp. and Eckenrode aided and abetted in each of the acts of extortion against Discon by permitting the true circumstances of such acts to be concealed during an investigation by the PSC.

IX. THE CONTROL AND COVER-UP SCHEMES

78. Each defendant understood that if state and federal regulators discovered the scheme to defraud ratepayers described in paragraphs 26 through 73, they would

take action to restrict or eliminate defendants' continued control of NYT. On October 3, 1990, after partial disclosure of the ratepayer frauds, the general counsel to the PSC reported that "ratepayers would be best served by a regulated telephone company that was divested from or became a fully separated subsidiary of NYNEX." Subsequently, the PSC required NYNEX to transfer the functions of MECo to a subsidiary owned by NYT and NET.

A. Abuse of NYT Security

79. Through agents of NYT Security, NYNEX Corp., MECo, and Eckenrode controlled NYT. Until July 1985, Friedman and Eckenrode had authority to hire NYT Security on a "confidential basis" that prevented it from disclosing the purpose or results of the investigation to responsible NYT personnel. After reviewing the investigative report that NYT Security prepared regarding Discon, the PSC staff concluded that NYT Security worked "on behalf of MECo," not NYT. Acting for NYNEX Corp. and MECo, investigators from NYT Security extorted, defamed, and retaliated against employees and vendors who refused to participate in the Eckenrode Synergy Plan or sought to report illegal activities to regulators. Because of NYNEX's abuses, the PSC has conducted an audit of NYT Security that it has not yet publicly released.

80. Michael Williams, who participated with Technologies on removals contracts, caused MECo to award business to his firms by providing gratuities to MECo personnel. MECo and NYT continued to do business with Williams even after he stole materials from a NYT central office. NYT Security failed to take effective action to protect NYT and its ratepayers from the effect of Williams' practices, from the receipt of gratuities by Friedman (*see* paragraph 33(g)), and from the theft of scrap by O'Reilly (*see* paragraph 76).

81. Because Friedman and O'Reilly threatened to reveal to regulators the Eckenrode Synergy Plan and

NYNEX's scheme to defraud ratepayers, Eckenrode, NYNEX Corp., and MECo tolerated acts of racketeering that provided personal benefits to Friedman, O'Reilly, and other MECo personnel at the expense of NYT, as described in paragraphs 33(g), 76, and 80. Eckenrode, NYNEX Corp., and MECo agreed to cause NYT (a) to forego efforts to seek restitution from Friedman and O'Reilly, (b) to avoid adequate corrective actions with to restore to equal status vendors that had been exorted or discriminated against, and (c) to provide false and misleading information to the PSC. As a result of this agreement, Eckenrode, NYNEX Corp., MECo, and NYT aided and abetted in the specified acts of racketeering.

B. Concealments From Regulators and Authorities

82. On March 22, 1985, March 26, 1986, March 27, 1987, March 28, 1988, March 27, 1989, and March 29, 1990, NYNEX Corp. filed its annual report on Form 10-K. Each such report omitted information that was material to purchasers of securities issued by NYNEX Corp. The material omissions included, but were not limited to: (1) the participation of Eckenrode in the design and implementation of the Eckenrode Synergy Plan; (2) the unlawful cross-subsidization by NET and NYT of unregulated affiliates; (3) the impact of markups on the stated value of telephone plant owned by NYNEX subsidiaries; (4) the unorthodox business practices of MECo executives and the involvement of senior NYNEX executives in the subsequent cover-up. The report dated March 29, 1990 materially misstated the exposure of NYNEX Corp. and its subsidiaries to regulatory liabilities by failing to note the commencement of an FCC audit in January 1989. In June 1990, when the *Wall Street Journal* disclosed the involvement of senior NYNEX executives in the cover-up of unorthodox business practices, the price of NYNEX Corp. common stock fell precipitously.

83. NYNEX Corp. caused each report identified in paragraph 82 to be transmitted by wire from New York

City to the offices of the SEC in Washington, D.C. and delivered by mail to various shareholders and other persons. The publication and distribution of these reports by mail and wire were essential parts of the scheme to defraud purchasers of NYNEX securities and NYT ratepayers. Each transmission constitutes a separate predicate act of mail fraud or wire fraud and a separate predicate act of fraud in the sale of securities. Eckenrode, who signed the report dated March 29, 1990, agreed to commit each of the predicate acts associated with the filing, publication and transmission of such reports.

84. On or about March 22, 1985, March 26, 1986, March 27, 1987, March 28, 1988, March 27, 1989, and March 29, 1990, NYT filed its annual report on Form 10-K. Each such report omitted information that was material to purchasers of debt securities issued by NYT. The material omissions included, but were not limited to: (1) the participation of Eckenrode in the design and implementation of the Eckenrode Synergy Plan; (2) the unlawful cross-subsidization by NET and NYT of unregulated affiliates; (3) the impact of markups on the stated value of telephone plant owned by NYNEX subsidiaries; (4) the unorthodox business practices of MECo executives and the involvement of senior NYNEX executives in the subsequent cover-up. The report dated March 29, 1990 materially misstated the exposure of NYT to regulatory liabilities by failing to note the commencement of an FCC audit in January 1989.

85. NYT caused each report identified in paragraph 83 to be transmitted by wire from New York City to the offices of the SEC in Washington, D.C. and delivered by mail to various shareholders and other persons. Each transmission constitutes a separate predicate act of mail fraud or wire fraud and a separate predicate act of fraud in the sale of securities.

86. NYNEX Corp. caused NYT and NET to make materially false statements to the FCC. These included:

(a) False statements in annual reports to the FCC included, but were not limited to, the failure to make financial statements consistent with generally acceptable accounting principals and applicable FCC instructions and regulations.

(b) NYNEX Corp. failed to include accurate information for all of its subsidiaries in the capitalization plan which, at times relevant to this complaint, it was required to file pursuant to 47 C.F.R. Part 68 ("*Computer II*").

(c) According to the audit report of the FCC, NYNEX provided information regarding, among other items, its cash and inventory requirements. As included in the audit report, the information is false. The time, date, and manner in which NYNEX made these misrepresentations in known to defendants. NYNEX also falsely told the FCC staff that MECo provided NYT a "firm contract price" on removals, when in fact it allowed one vendor, Technologies, to bill job changes to NYT. As an essential part of NYNEX's attempted fraud, the FCC mailed the audit report to a party who intervened in its show cause order.

87. NYNEX Corp. caused NYT and NET to make materially false statements to the IRS.

(a) As a result of inflated prices paid for capital equipment and capitalized expenses, the asset bases of NYT and NET is overstated by approximately ten percent. Upon information and belief, NYNEX has misstated the value of its assets on returns to the IRS. This has resulted in claims for excessive depreciation expense and improper tax credits.

(b) NYNEX also claimed as business and capital expenses payments that were illegal under state and federal laws. These payments included, but not limited to, payments to affiliates in violation of sections 90(3), 107, and 110(3) of the New York Public Service Law.

(c) NYNEX Corp. misstated its financial results on state and federal tax returns, deducted illegal payments as

legitimate business expenses, and claimed excessive amounts of depreciation in violation of 29 U.S.C. § 162(c)(2).

C. Extortion of Employees and Vendors

88. NYNEX placed employees who questioned the Eckenrode Synergy Plan and other violations of the consent decree in fear of economic loss. NYNEX fired employees, including Zirkelbach and Tobias Squitieri, who refused to participate in unlawful activities. MECo also retaliated against one of these employees by withholding approximately $21,000 in expense vouchers. As described in paragraph 63, MECo retaliated against an employee who protested its discrimination in favor of AT&T. Each such act of intimidation and retaliation of employees constitutes a separate predicate act of extortion.

89. As described in paragraph 77 and the paragraphs to which it refers, MECo, through O'Reilly and others, committed at least four acts of extortion by placing Discon in fear of economic loss unless Discon participated in unlawful conspiracies. MECo and O'Reilly threatened to drive Discon "out of business" unless Discon concealed its costs from NYT and helped to defraud a scrap dealer.

D. "Hush Money" Payments and Obstructions of Justice

90. From at least as early as January 1989 until June 1992, federal criminal investigators have made inquiries into the activities of NYNEX. Discon and other parties have provided information relating to crimes committed by NYNEX.

91. NYNEX Corp. caused NET to make payments to a discharged employee who had complained that non-economic transactions with affiliates were illegal. According to her attorney, NET entered a settlement with the provision that the discharged employee could not disclose her allegations to the criminal investigators.

92. As alleged in paragraph 63, NYNEX Corp. and MECo caused payments to be made to a former employee against whom it had retaliated after he complained that MECo was discriminating in favor of AT&T on the condition that he would not provide information to public authorities.

93. After Friedman threatened to disclose criminal activity to regulators, NYNEX Corp., MECo and Eckenrode caused NYNEX to make a series of payments to Friedman totaling one million dollars. Although these defendants structured the payments as a settlement of sham litigation alleging religious discrimination, the agreement provided that the payments would cease if Friedman reported crimes to criminal investigators.

94. Because NYNEX Corp., MECo, NYT, and Eckenrode caused each payment identified in paragraphs 91 through 93 to be made with the corrupt intent to induce Friedman not to report evidence of alleged crimes, each payment constitutes a separate predicate act of obstruction of justice. The payments identified in paragraphs 91 and 93 also constitute separate predicate acts of obstruction of a criminal investigation.

95. There are additional anticompetitive acts and acts of racketeering, information regarding which is contained in discovery conducted in proceedings before the PSC, but which is currently subject to orders restricting its use. There are additional anticompetitive acts and acts of racketeering, information regarding which is in the control of PSC officials conducting or supervising the pending audits of NYT Security and of NYT's transactions with affiliates. The PSC has not yet released the results of these audits to the public.

96. There are additional anticompetitive acts and acts of racketeering, information regarding which is in the exclusive control of defendants.

X. CLAIMS FOR RELIEF

COUNT ONE
15 U.S.C. § 2
(Sherman Act, Section 2—attempt to monopolize)

97. Discon realleges paragraphs 1 through 96 as if fully set forth herein. Discon specifically realleges paragraphs 2 and 21 through 58.

98. Under this arrangement, MECo and Technologies have maintained at least 80 percent of the market for removal services in New York State. The arrangement has substantially lessened and eliminated competition in the market for removal services in New York State and contiguous areas ("New York State area" market).

99. Because of the restrictions of the consent decree, the regulatory, technical and economic requirements of NYT for removal services differ from those of interexchange and independent local carriers in and adjacent to its service area (which includes most of New York State and parts of Connecticut). At times relevant to this complaint, MECo and Technologies maintained at least 95 percent of the market for removal services at NYT.

100. NYNEX Corp., NYT and MECo attempted to monopolize the markets for removal services at NYT and in the New York State area. NYT has market power by virtue of its local telephone monopoly. NYNEX Corp. and MECo specifically intended to use this market power to exclude competition from the markets for removal services. There was a dangerous probability that their attempt would succeed, and it did succeed.

101. This attempt to monopolize violated Section 2 of the Sherman Act, 15 U.S.C. § 2.

102. These violations injured Discon in its business and property. As a direct and proximate result of this attempted monopolization, Discon was put out of business, which denied Discon the opportunity to obtain jobs and

to generate profits in an amount not yet ascertained. Discon prays for treble damages, attorneys' fees, and the costs of this suit.

COUNT TWO
15 U.S.C. § 2
(Sherman Act, Section 2—monopolization)

103. Discon realleges paragraphs 1 through 102 as if fully set forth herein. Discon specifically realleges Count One and the paragraphs to which it refers.

104. As a result of actions, taken in concert with AT&T, NYNEX and MECo effectively controlled the price at which contracts for removal services were obtained. NYNEX and MECo acquired and maintained power to restrict or eliminate competition in this markets for removal service at NYT and in the New York State area.

105. The successful monopolization of the market for removal services in the New York State area and of the market for NYT removal services has injured Discon in its business and property. As a direct and proximate result of this successful monopolization, Discon was put out of business, which denied Discon the opportunity to obtain jobs and to generate profits in an amount not yet ascertained. Discon prays for treble damages, attorneys' fees, and the costs of this suit.

COUNT THREE
15 U.S.C. § 2
(Sherman Act, Section 2—conspiracy to monopolize)

106. Discon realleges paragraphs 1 through 105 as if fully set forth herein. Discon specifically realleges Count One and the paragraphs to which it refers.

107. NYNEX Corp., MECo and NYT combined and conspired with others, including Technologies, McGee and LISN, with the specific intent to violate Section 2 of the

Sherman Act by monopolizing the markets for removal services at NYT and in the New York State area. Overt acts in support of this conspiracy include those identified in paragraphs 31, 33 through 39, 41, 46, 47, 49 through 51, 54 through 57.

108. The conspiracy to monopolize the markets for removal services at NYT and in the New York State area has injured Discon in its business and property. As a direct and proximate result of this conspiracy to monopolize, Discon was put out of business, which denied Discon the opportunity to obtain jobs and to generate profits in an amount not yet ascertained. Discon prays for treble damages, attorneys' fees, and the costs of this suit.

COUNT FOUR
15 U.S.C. § 1
(Sherman Act, Section 1)

109. Plaintiff realleges paragraphs 1 through 108 as if fully set forth herein. Discon specifically realleges paragraphs 26 through 63.

110. MECo and Technologies entered into an arrangement to fix prices and to restrict competition in the markets for removal services at NYT and in the New York State area. This arrangement also attempted to fix prices and to restrict competition for other products and services purchased with funds from NYT's regulated accounts, such as transmission and switching equipment. The arrangement included agreements (a) that MECo, through Friedman and NYT, would decertify Discon and make false statements regarding Discon to the PSC, (b) that Technologies would not deal directly with NYT or divulge its prices to NYT, (c) that MECo would award virtually all its contracts from NYT to Technologies as a subcontractor, (d) that MECo would mark up these contracts to prices at or near the predivestiture level, and (e) that MECo and Technologies would divide the resulting mo-

nopoly profits through a system of rebates and reciprocal dealings. As a result of this agreement, NYT paid inflated prices, which NYNEX Corp. caused NYT unlawfully to pass on to monopoly ratepayers.

111. NYNEX Corp. engaged attorneys and accountants to participate in this conspiracy by concealing information from responsible government authorities.

112. NYNEX Corp. and MECo's participation in this combination and in the related conspiracies has violated and continues to violate Section 1 of the Sherman Act, 15 U.S.C. § 1.

113. These restraints of trade injured Discon in its business and property. As a direct and proximate result of this conspiracy and combination to restrain trade, Discon was put out of business, which denied Discon the opportunity to obtain jobs and to generate profits in an amount not yet ascertained. As a further direct and proximate result of the conspiracy to restrain trade, Discon paid increased rates for telephone service in an amount not yet ascertained, but believed to be in excess of $1,800. Discon prays for treble damages, attorneys' fees, and the costs of this suit.

COUNT FIVE
18 U.S.C. § 1962(c)
(RICO conduct enterprise)

114. Discon realleges paragraphs 1 through 113 as if fully set forth herein. Discon specifically realleges paragraphs 64 through 77.

115. NYNEX, which includes NYNEX Corp. and each of its subsidiaries, is an enterprise, as defined in 18 U.S.C. § 1961(4). The enterprise includes attorneys, accountants and other agents whom NYNEX has engaged. It is group of entities and individuals associated in fact who engage in and whose activities affect interstate com-

merce. NYNEX exists separate and apart from the pattern of racketeering.

116. NYNEX Corp., MECo, NYT, Eckenrode, O'Reilly and other persons unlawfully and knowingly conducted and participated in the affairs of NYNEX through a pattern of racketeering activity, in violation of 18 U.S.C. § 1962(c).

117. NYNEX Corp., MECo, NYT, Eckenrode, O'Reilly and other persons each agreed to commit multiple acts of "racketeering activity," as defined in 18 U.S.C. § 1961(1). These multiple acts constitute a "pattern of racketeering activity," as defined in 18 U.S.C. § 1961(5) because these acts were interrelated and formed part of a common and continuous series of unlawful, fraudulent and injurious schemes perpetrated to achieve the same or similar purposes. These same and similar purposes included (a) the fraudulent inflation of costs recovered by NYT from Discon and other ratepayers under regulation, (b) the subsidization of unregulated NYNEX affiliates through fraudulent transactions and diversions from NYT of funds and assets, including scrap, (c) the corrupt exaction of favors and other things of value from suppliers to the benefit of unregulated affiliates and certain of their employees, (d) the retaliation against employees and vendors who failed to participate in unlawful activities or threatened to disclose them to regulators, and (e) the concealment from regulators and prosecutors of unlawful acts.

118. The multiple acts of racketeering that NYNEX Corp. agreed to commit include those described in paragraphs 69, 73, 83, and 94.

119. The multiple acts of racketeering that MECo agreed to commit include those described in paragraphs 73, 77, 88, 89, and 94.

120. The multiple acts of racketeering that NYT agreed to commit include those described in paragraph 77, 85, 86 and 94.

121. The multiple acts of racketeering that Eckenrode agreed to commit include those described in paragraphs 69, 83, 86, and 94.

122. The multiple acts of racketeering that O'Reilly agreed to commit include those described in paragraphs 38 and 73 through 77.

123. Each of the defendants aided and abetted in acts of racketeering committed by the other defendants.

124. The conduct of NYNEX's affairs through this pattern of racketeering activity injured Discon in its business and property. The fraudulent concealment of Discon's low prices from its customers, prospective customers, and interested regulators deprived Discon of opportunities to expand its business and to increase its market share. The extortion of Discon by O'Reilly and MECo forced Discon to perform work without compensation, even when compensation had been agreed. The fraudulent statements made regarding Discon caused its principal customer to decertify it, forcing Discon out of business. As a direct and proximate result of the pattern of racketeering, including the acts of racketeering that defendants committed, Discon was put out of business, which denied Discon the opportunity to obtain jobs and to generate profits in an amount not yet ascertained. The fraudulent markups required Discon to pay higher regulated telephone rates in an amount not yet ascertained, but believed to be in excess of $1800. Discon prays for treble damages, attorneys' fees, and the costs of this suit.

COUNT SIX
18 U.S.C. § 1962(b)
(RICO controlled enterprise)

125. Discon realleges paragraphs 1 through 124 as if fully set forth herein.

126. NYT is an enterprise, as defined in 18 U.S.C. § 1961(4). NYT is engaged in interstate commerce. Its activities, including the procurement of removal services, affect interstate commerce. NYT exists separate and apart from the pattern of racketeering.

127. NYNEX Corp., MECo, Eckenrode, O'Reilly and other persons known and unknown unlawfully and knowingly maintained control of NYT through a pattern of racketeering activity, in violation of 18 U.S.C. § 1962(b).

128. NYNEX Corp., MECo, NYT, Eckenrode, O'Reilly and other persons each agreed to commit multiple acts of "racketeering activity," as defined in 18 U.S.C. § 1961(1). These multiple acts constitute a "pattern of racketeering activity," as defined in 18 U.S.C. § 1961(5) because these acts were interrelated and formed part of a common and continuous series of unlawful, fraudulent and injurious schemes perpetrated to prevent regulators from discovering unlawful acts that would have caused them to restrict defendants' control of NYT.

129. The multiple acts of racketeering that NYNEX Corp. committed include those described in paragraphs 69, 73, 83 and 94.

130. The multiple acts of racketeering that MECo committed include those described in paragraphs 69, 73, 77, 88, 89 and 94.

131. The multiple acts of racketeering that Eckenrode committed include those described in paragraphs 69, 83, 86 and 94.

132. The multiple acts of racketeering that O'Reilly committed include those described in paragraph 38 and 73.

133. Each of these defendants agreed to aid and abet acts of racketeering committed by each of the other defendants for the purpose of controlling NYT.

134. Each of these defendant agreed to commit multiple acts of racketeering.

135. As a direct and proximate result of the control of NYT by NYNEX through the pattern of racketeering activity, Discon suffered injury in its business and property. Defendants' control of NYT further injured Discon by causing Discon to be decertified by its principal customer, effectively putting Discon out of business, which denied Discon the opportunity to obtain jobs and to generate profits in an amount not yet ascertained. Defendants' control of NYT further injured Discon by causing NYT to charge Discon excessive telephone rates. The fraudulent markups required Discon to pay higher regulated telephone rates in an amount not yet ascertained, but believed to be in excess of $1800. Discon prays for treble damages, attorneys' fees, and the costs of this suit.

COUNT SEVEN
18 U.S.C. § 1962(d)
(RICO Conspiracy)

136. Discon realleges paragraphs 1 through 135 as if fully set forth herein. Discon specifically realleges Counts Five and Six and the paragraphs to which they refer.

137. NYNEX, MECo, NYT, Eckenrode, O'Reilly and other persons consciously agreed to join and to enter a conspiracy to violate 18 U.S.C. § 1962(c) by conducting the affairs of NYNEX through a pattern of multiple acts of racketeering. Overt acts of this conspiracy include the acts of racketeering to which paragraphs 118 through 122 refer. Each defendant agreed to commit acts of racketeering as specifically alleged in those paragraphs.

138. NYNEX, MECo, NYT, Eckenrode, O'Reilly and other persons consciously agreed to join and to enter a conspiracy to violate 18 U.S.C. § 1962(b) by controlling NYT through a pattern of multiple acts of racketeering. Overt acts of this conspiracy include the acts of racketeering to which paragraphs 129 through 132 refer. Each defendant agreed to commit acts of racketeering as specifically alleged in those paragraphs.

139. By reason of those agreements to commit acts of racketeering, NYNEX, MECo, NYT, Eckenrode and O'Reilly, with other persons known and unknown, unlawfully, knowingly and willfully conspired to violate the provisions of 18 U.S.C. § 1962(b) and (c), in violation of 18 U.S.C. § 1962(d).

140. Defendants committed other overt acts in furtherance of the conspiracy. These acts included, but were not limited to, (a) the predicate acts of racketeering enumerated in paragraphs 118 through 122 and 129 through 132 and (b) all acts, whether or not otherwise lawful, that furthered the schemes described in paragraph 117.

141. These acts injured Discon in its business and property for the reasons stated in paragraphs 124 and 135. Discon is entitled to damages as set forth in these paragraphs.

COUNT EIGHT
DONNELLY ACT

142. Discon realleges paragraphs 1 to 141 as if fully set forth herein. Discon specifically realleges Courts One through Three and the paragraphs to which they refer.

143. Defendants' conduct actually restrained competition in the market for removal services in New York State.

144. Defendants' activities violated the General Business Law of New York, Article 22, Section 340.

145. These acts injured Discon in its business and property. Discon is entitled to legal and equitable relief for the reasons and to the extent set forth in paragraph 102, 105 and 108.

COUNT NINE
PRIMA FACIE TORT

146. Discon realleges paragraphs 1 to 145 as if fully set forth herein. Discon specifically realleges that the conduct described in paragraphs 26 to 96 maliciously injured Discon.

147. In the alternative to Discon's allegation that defendants retaliated against Discon for the purpose of defrauding NYT ratepayers and concealing such frauds from regulators, Discon alleges that defendants had no motivation other than the desire maliciously to injure Discon.

148. To the extent that these actions did not support the anticompetitive scheme alleged elsewhere in this Complaint, they had no motivation other than the desire maliciously to injure Discon.

149. In the alternative to its claim that defendants' action supported their anticompetitive scheme, plaintiff claims that defendants have committed prima facie tort, in violation of the common law of the state of New York.

150. These acts injured Discon in its business and property. The injuries include the loss of business for Discon to an extent and in an amount not yet ascertained. Defendants are therefore jointly and severally liable to Discon for money damages in an amount unknown at this time, but believed to be in excess of $15 million.

151. Defendants' actions were directed at the public generally because they had the foreseeable effect of injuring ratepayers by depriving them of the benefits of competitive procurement. To deter recurrence of this conduct, Discon prays for an award of punitive damages in the amount of $30 million.

COUNT TEN
THIRD PARTY BENEFICIARY
(MECo Supply Contact)

152. Discon realleges paragraphs 1 through 151 as if fully set forth herein. Discon specifically realleges paragraphs 24 and 73.

153. The MECo Supply Contract requires MECo to maintain reasonable prices and to publish a price list.

154. In entering this contract, NYT specifically intended to benefit independent suppliers and to induce them to supply NYNEX through MECo by assuring them that MECo will not unreasonably mark up their prices. NYT also specifically intended the required disclosure of MECo's prices to allow suppliers to determine where they can effectively compete and reduce prices to NYT and its ratepayers.

155. The MECo Supply Contract is governed by New York law.

156. Because these provisions specifically benefit Discon and other general trade suppliers, they can enforce them as third-party beneficiaries.

157. MECo breached its obligation to maintain reasonable, published prices.

158. This breach injured Discon (1) by permitting the scheme of inflated markups to go undetected by regulators and (2) by depriving Discon of the promised opportunity to compete where it had an economic advantage, causing it to lose contracts in an amount not yet ascertained.

COUNT ELEVEN
BREACH OF CONTRACT
(Discon Supply Contract)

159. Discon realleges paragraphs 1 to 158 as if fully set forth herewith. Discon specifically realleges paragraph 48.

160. MECo breached this written terms of the contract described in paragraph 48 (Exhibit 1) by delaying payments to Discon, by failing to make payments, and by requiring Discon to perform work without compensation.

161. MECo breached the oral terms of this contract by failing to permit Discon to bid on removal contracts that MECo managed.

162. The contract implies a covenant of fair dealing, including implied terms (1) that MECo will not arbitrarily disqualify or retaliate against Discon; (2) that MECo would not rig bids or otherwise discriminate against Discon; and (3) that MECo would not force Discon to perform services outside awarded contracts without compensation.

163. MECo's breach of this contract, which NYNEX Corp. induced, injured Discon in its business and property. Defendants are liable to Discon in an amount not yet ascertained.

COUNT TWELVE
COMMON LAW DEFAMATION

164. Discon realleges paragraphs 1 to 163 as if fully set forth herewith.

165. NYNEX Corp. and MECo caused NYT to make a statement to the PSC in September 1989 that Discon "considered [a loan to an affiliate of Zirkelbach] to be a loan that would not be repaid." NYNEX Corp., MECo, and NYT knew this statement to be false or made the statement with reckless or negligent disregard for the truth. NYNEX Corp., MECo, and NYT caused the PSC to republish this defamation in December 1989 and in or around March 1990.

166. NYNEX Corp. and MECo caused NYT, through its spokesman Tony Pappas, to tell *Newsday* that "Faltisco had loaned Zirkelbach $9,300 interest free, which is why

[MECo] stopped doing business with [Discon]." NYNEX Corp., MECo, and NYT knew this statement to be false or made the statement with reckless or negligent disregard for the truth. *Newsday* republished this defamation on July 29, 1990.

167. NYNEX Corp. attempted to prevent the PSC from disclosing that the defamation had occurred. In May 1990, the PSC determined that its argument lacked any basis in law. Upon information and belief, NYNEX Corp. and MECo may have fraudulently concealed similarly defamatory statements made to prospective customers of Discon.

168. These statements injured Discon's business reputation and its ability to obtain work from prospective customers. It also delayed action by the PSC against MECo's unlawful procurement practices. Defendants are liable to Discon in an amount not yet ascertained.

COUNT THIRTEEN
CIVIL CONSPIRACY

169. Discon realleges paragraphs 1 to 168 as if fully set forth herewith.

170. Defendants agreed with other persons known and unknown ("conspirators") to commit the illegal acts described in Counts One through Twelve.

171. The conspirators committed overt acts in furtherance of this agreement that injured Discon.

172. Defendants are liable for any adverse consequences of such acts.

173. These acts injured Discon in its business and property. Defendants are liable to Discon in an amount not yet ascertained.

WHEREFORE, plaintiff demands trial by jury and prays for an award of threefold the damages suffered by

virtue of the antitrust and racketeering conspiracies, plus additional actual and punitive damages and interest, reasonable attorneys' fees and other costs associated with this suit, in an amount not yet ascertained, but believed to exceed $75 million; and for an Order granting such further relief as the Court deems just and proper.

Dated: July 31, 1992

/s/ George J. Navagh
GOLDSTEIN, NAVAGH
BULAN & CHIARI
By: George J. Navagh, Esq.
14 Lafayette Square
Suite 1440
Buffalo NY 14208
716-854-1332

Judgment of the Court of Appeals,
dated August 26, 1996

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 26th day of August, one thousand nine hundred and ninety-six.

PRESENT: HON. JON O. NEWMAN
Chief Judge
HON. JAMES L. OAKES
HON. FRED I. PARKER
Circuit Judges

Docket No: 95-7673

DISCON INCORPORATED,
Plaintiff-Appellant,
v.

NYNEX CORPORATION;
NYNEX MATERIAL ENTERPRISES;
NEW YORK TELEPHONE COMPANY;
ROBERT J. ECKENRODE; and BERNARD O'REILLY,
Defendants-Appellees.

Appeal from United States District Court
for the Western District of New York

JUDGMENT

This cause came on to be heard on the transcript of record from the Western District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ORDERED, ADJUDGED, and DECREED that the judgment of said district court be and it hereby is affirmed in part, reversed in part, and remanded to the said district court for further proceedings in accordance with the opinion of this court.

For the Court

GEORGE LANGE III
Clerk

By /s/ Beth J. Meador
BETH J. MEADOR
Administrative Attorney

Order of the Supreme Court of the United States
Granting Writ of Certiorari, dated March 23, 1998

SUPREME COURT OF THE UNITED STATES

No. 96-1570

NYNEX CORPORATION, *et al.*,
Petitioners

v.

DISCON, INCORPORATED

ORDER ALLOWING CERTIORARI

Filed March 23, 1998

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

March 23, 1998

Supreme Court, U.S.
FILED
JUN 20 1998
OFFICE OF THE CLERK

No. 96-1570

In The

Supreme Court of the United States

October Term, 1997

NYNEX CORPORATION, *et al.*,

Petitioners,

vs.

DISCON, INCORPORATED,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENT

RECEIVED
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LAWRENCE C. BROWN
Counsel of Record
JOHN H. RING, III
Attorneys for Respondent
360 Dingens Street
Buffalo, New York 14206
(716) 826-3038

147402

(800) 274-3321 • (800) 359-6859
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QUESTIONS PRESENTED

1. Whether an agreement between a purchaser and a supplier to eliminate a competing supplier may be condemned as an unlawful group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

2. Whether a purchaser may conspire to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2, when the purchaser agrees with a supplier to eliminate a competing supplier with the specific intent to assist the first supplier in its acquisition or maintenance of monopoly power.

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STATEMENT

Respondent, Discon Incorporated ("Discon"), had, as its primary business, provision of "removal services" to telephone companies, those being the "salvage and disposal of obsolete telephone central office equipment". J.A. 78 (Am. Compl. ¶ 13). Petitioner NYNEX Corporation (NYNEX) was, during the period covered by the Amended Complaint, the parent corporation of Petitioner New York Telephone Company (NYT), a provider of regulated telephone service in the State of New York, and of Petitioner NYNEX Material Enterprises Company (ME Co.), a subsidiary of NYNEX after December 31, 1983, which was originally created by American Telephone and Telegraph Company (AT&T) to purchase products and services "to achieve economies and other increased efficiencies". J.A. 82 (Am. Compl. ¶ 24). AT&T caused MECo. and NYT to enter an agreement on December 30, 1983 which purported to provide to NYT a procurement entity. Thereafter, AT&T transferred control of MECo. to NYNEX on January 1, 1984 as part of the AT&T divestiture litigation.[1]

AT&T, as part of the divestiture process, formed certain subsidiaries, AT&T Technologies (Technologies) and AT&T Communications (ATC). Technologies was in the business of removal services. ATC was in the business of providing interexchange services which required removal services for its equipment.

MECo. exercised authority granted to it by NYNEX to approve vendors to NYT, including removal services. Prior to MECo.'s transfer to NYNEX on January 1, 1984, the NYT-MECo. agreement of December 30, 1983 contemplated publication of price lists to third party vendors of services to encourage suppliers such as Discon to offer services to NYT through ME Co. to facilitate the undercutting of existing prices, many of which AT&T had set when Western Electric was a monopoly supplier. J.A. 82 (Am. Compl. ¶ 24).

Prior to the AT&T divestiture, Western Electric, Technologies' predecessor, performed virtually all removals at NYT's central exchange offices. Post-divestiture, Technologies was the exclusive

1. *United States v. American Tel. And Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub. nom. Maryland v. United States*, 460 U.S. 1001 (1983) (hereafter "AT&T Case").

supplier of removal services to ATC. J.A. 82-83 (Am. Compl. ¶ 26).

The AT&T Case consent decree required NYT to provide equal access to interexchange service. Consequently, NYT had to remove substantial portions of its central offices' equipment and install new electronic switches. The NYT network services requirements were approximately $50 million annually after divestiture. J.A. 83 (Am. Compl. ¶ 28). NYT, as of December 31, 1989, after divestiture, served 89.9% of all local lines in New York State and supplied more than 95% of exchange service and exchange access. J.A. 81 (Am. Compl. ¶ 33).

Initially in 1984, Discon bid and sold removal services to NYT directly and through ME Co. In June 1984, and thereafter for a two-year period, AT&T, NYT, NYNEX, MECo. and Technologies, through their personnel, engaged in a number of overt acts to prevent and exclude Discon from competing in the market for removal services, including, for example, redirecting of contracts to Technologies although same had been awarded by NYT to Discon as the lowest bidder. J.A. 84-92 (Am. Compl. ¶¶ 32-57).

In June 1986, Discon was decertified by MECo. as an approved vendor for MECo. and NYT, and thereby precluded from submitting bids for removal services at NYT or for NYT. Thereafter, in September 1986, a MECo. employee advised Discon's principal that Discon would not be permitted to work for MECo. or NYT until Discon signed a release and returned evidence of illegal markups and incidents of discrimination favoring Technologies. J.A. 91 (Am. Compl. ¶¶ 55-56).

In May 1988, subsequent to an audit of NYT by the New York Public Service Commission (PSC), NYNEX directed NYT to deal directly with vendors for all removals. By this time, Discon had ceased business. J.A. 92 (Am. Compl. ¶ 58).

Subsequent to the PSC's audit and the existence of Federal Communications Commission (FCC) investigations and hearings, Discon concluded it had been the subject of conduct violating the anti-trust laws and sued for treble damages under the Sherman Act, 15 U.S.C. §§ 1, 2, & 5. The Court of Appeals held that Discon had alleged two valid anti-trust claims, for conspiracy in restraint of trade

and conspiracy by the Petitioners herein to assist Technologies in monopolization of the market for removal services. (Pet. App. 12a-13a, 14a-15a).

The Court of Appeals' decision should be sustained. The court recognized that the Petitioners' activity, with that of Technologies, was addressed to stifling of or suppression of competition in the removal services market. The removal services market was not regulated. MECo. was set up as a regulation avoidance mechanism. The court addressed anti-trust issues raised in the Amended Complaint, that the regulation avoidance mechanism chosen by the Petitioners participated in the conspiracy to suppress and/or eliminate competition in the removal services market in which one of the conspirators competed. The harm to competition is evident where MECo., essentially a gatekeeper that designated who could compete in the removal services market, was used as an instrument by NYNEX and AT&T to suppress or destroy competition in the removal services market and thereby advance AT&T's (Technologies') efforts to monopolize that market.

A. The Amended Complaint

Discon's Amended Complaint was determined, by the Court of Appeals, to state two valid antitrust claims, for conspiracy in restraint of trade and conspiracy to monopolize. The determination was made in the context of a motion to dismiss, with the allegations of the Amended Complaint assumed to be true.

Discon's Amended Complaint set forth allegations that NYNEX, NYT and MECo. engaged in overt conduct in furtherance of a conspiracy to effect exclusion of Discon from the market for provision of removal services to NYT and in the State of New York. The particulars of the conspiracy, as evinced by overt acts and certain agreements have been plead in paragraphs 26 to 58 and 110 to 112 of the Amended Complaint. J.A. 82-92, 112-113. These acts were all directed against Discon's efforts to compete in the market for provision of removal services to NYT and in the New York State area.

Subsequent to divestiture, NYT was responsible to provide equal access to interexchange carriers, resulting in the need for a large number of equipment removals and installation of exchange

control offices. J.A. 81 (Am. Compl. ¶ 22). After divestiture, NYT was the dominant exchange carrier in New York State, serving 89.9% of all network access lines in the State and providing over 95% of exchange service and exchange access respecting those lines. J.A. 81 (Am. Compl. ¶¶ 22-23).

The AT&T Case consent decree, controlling divestiture, required NYT to effect equipment removals, to provide equal access to interexchange services, with installation of new electronic switches. This resulted in NYT having post-divestiture network service requirements of about $50 million per year. J.A. 83 (Am. Compl. ¶ 28). ATC, as the result of divestiture, operated an interexchange network in New York State, complementing the NYT provision of equal access to interexchange service. With NYT's dominance of the exchange carrier service and ATC's complementing dominance of the interexchange network, the two firms were the dominant purchasers of removal services in New York State. J.A. 82-83 (Am. Compl. ¶¶ 26, 28 and 29).

The Amended Complaint sets forth the pre-divestiture structure of the provision of removal services, the allegations in respect of which provide the basis for the allegation that Technologies is the dominant provider of removal services in the State of New York and to NYT. Prior to divestiture, Western Electric Company, Inc., Technologies' predecessor, performed virtually all removal services at NYT's central exchange offices. J.A. 82 (Am. Compl. ¶ 26). Technologies, post-divestiture, continued to be the exclusive supplier of removal services to ATC. J.A. 82-83 (Am. Compl. ¶ 26). It was well-positioned to compete with Discon in the provision of removal services to NYT, both as the successor to Western Electric and by taking advantage of its parent's, AT&T's, making of agreements with NYNEX and MECo. to obtain beneficial discriminatory treatment in competition with Discon for projects on which Discon bid or was asked to bid for removal services. The overt acts of Technologies, MECo., AT&T and NYNEX are set forth in the Amended Complaint, and give fair notice of the events being alleged as constituting a conspiracy to suppress competition to perpetuate Technologies' dominant position as supplier of removal services. These acts are set forth at J.A. 82-92 and 112-113 (Am. Compl. ¶¶ 26-58 and 112-113), and include the reassignment to Technologies of removal

contracts won by Discon as low-bidder, J.A. 86 (Am. Compl. ¶ 34), and MECo. personnel advising Discon's principal in September 1986 that Discon would not work for MECo. or NYT until a release was signed and evidence of incidents of discrimination in favor of Technologies was returned. J.A. 91 (Am. Compl. ¶ 56).

In a period commencing early in 1984, NYT was directly bidding out and awarding jobs to Discon as low-bidder, when MECo. engaged in a series of retaliatory acts was to coerce Discon to work only through MECo. Examples were plead by Discon. J.A. 86-91 (Am. Compl. ¶¶ 34 [job reassignment to Technologies], 36 [Technologies to have supervisory and quality control responsibility on contracts awarded to Discon], 37 [ME Co. refused to provide written contracts or authorization for three substantial projects in violation of procurement procedures], 38 [ME Co. impose obligations on Discon outside of contract terms], and 43 [Technologies complains to NYT it lost a bid because ME Co. marked Discon's bid up less than Technologies']).

The impact of the aforesaid practices against Discon was magnified in the context of removal services for NYT in that most Bell Operating companies (BOC(s)), after divestiture, determined to either use unaffiliated contractors for removal services or to use employees whose wages were charged directly into regulated accounts. Of over 400 removals to be performed for NYT, its personnel did four (1%), NYT administered bids for about forty (about 10%), and MECo. was contracted for the remainder. J.A. 83 (Am. Compl. ¶ 27).

In June 1986, MECo. decertified Discon as an approved vendor, although no reason was given and NYT personnel refused to meet with Discon to explain the actions. J.A. 91, (Am. Compl. ¶¶ 54-55). Contrary to what the Petitioner chose to present as the reason for Discon's termination as a vendor, that such reason was a pretext is clear from MECo.'s approach to Discon's principal in September 1986, advising that Discon could not work for MECo. until he signed a release and returned evidence of incidents of discrimination in favor of Technologies. J.A. 92 (Am. Compl. ¶ 56).

Discon's termination was merely the final step in the effort of NYNEX, MECo. and Technologies to suppress competition in the

removal services market, a step which MECo. offered to reverse upon receipt of a release and return of evidence of illegal bid markups and of incidents of discrimination in favor of Technologies. J.A. 91, (Am. Compl. ¶¶ 54-57). Petitioners' assertion that Discon merely alleges its termination as a supplier to "NYNEX" was the result of a conspiracy between AT&T and NYNEX by alleging no more than a agreement to "discriminate against Discon" and to "eliminate Discon from the market" ignores the pleading of specific overt acts culminating in a request by MECo. to Discon to give a release and surrender evidence of discrimination favoring Technologies' if Discon wanted an opportunity to work for MECo. and NYT. J.A. 84-91 (Am. Compl. ¶¶ 33-56). The MECo.-Technologies Agreement referred to at J.A. 112 (Am. Compl. ¶ 110), was, in part, that Discon would be decertified as a vendor and discredited before public authorities, with the balance of the allegations therein referring to how MECo. and Technologies would structure their relationship respecting removal services to be provided through MECo. by Technologies. These allegations, including reference to specific overt acts, establish conduct to stifle competition by effecting an exclusion of Discon from the removal services market.[2]

Petitioners persist in characterizing the Amended Complaint as a scheme undertaken "by NYNEX to engage in regulatory fraud as a seller of telephone services." Pet. Br. at 6. A basic flaw in that perspective is that the Amended Complaint addresses and alleges the creation of a regulation avoidance entity, MECo, which NYNEX, AT&T and Technologies used to stifle Discon's competition with

2. Petitioners state, Pet. Br. at 5, that Discon characterizes its Amended Complaint, not as alleging a "full requirements" or other exclusive-dealing contract between NYNEX and AT&T, but as alleging AT&T provided "the lion's share" of removals needed by NYNEX, citing Respondent's Br. In Opp. at 5. The text of Br. In Opp. actually refers to NYT and AT&T being the dominant purchasers of removal services in New York State and that MECo. and Technologies were the dominant suppliers of removal services, with Technologies performing all removals needed by ATC and, through ME Co., the "lion's share" of removals needed by NYT. The Br. In Opp. text referred to by Petitioner deals with dominance in the purchaser and supplier markets, not characterization of an "agreement".

Technologies, after the removal services' market competition was eliminated, Petitioners then were able to defraud regulators.[3]

Petitioners' observation that the Amended Complaint contains no allegations about exclusion of other competitors selling removal services, about resulting constriction of supply that harmed the buyers of removal service (telephone companies) or about barriers to entry into the business (Pet. Br. at 5-6) is inaccurate in the sense that Petitioners are aware that MECo certified and approved removal service providers for work with MECo. and NYT, as part of its agreement with NYT to procure services and products. MECo's characteristics, its relationships with the other Petitioners and Technologies, and the use of its powers against Discon are alleged throughout the complaint. J.A. 79 (Am Compl. ¶ 16), J.A. 82 (Am. Compl. ¶¶ 33 (e-g), 34, 37 and 38). The regulated recipient of removal services was controlled by the participants in the conspiracy to exclude Discon and was deemed by a regulating authority to have been the subject of MECo's unreasonable charges and markups.[4]

3. The Petitioners use of MECo. as a regulatory avoidance entity is reflected in Petitioners' position in *New York Telephone Company*, 5 F.C.C.R. 866 (1990) (enforcement action for unreasonable markups and overcharges by MECo. incorporated into NYT's rate base) and the resulting settlement by consent decree, 5 F.C.C.R. 5892 (1990) in which one of the negotiated points was that there was no resolution of the federal agency's jurisdiction over MECo, an NYT defense in the proceeding. Petitioners implicitly acknowledge that MECo was an unregulated affiliate of NYT in the dispute with the FCC on whether an unregulated affiliate is limited to a regulated entity's prescribed rate of return as part of the FCC's investigation of unreasonable markups by MECo. Br. For Petrs. at 7 n.6. This corresponds with Respondents' allegations, in the Amended Complaint, that MECo was created to avoid regulation, and consequently was intended to operate in an unregulated market. J.A. 79 (Am. Compl. ¶ 16), J.A. 80-81 (Am. Compl. ¶ 21), J.A. 82 (Am. Compl. 24-25). MECo's creation was in the context of the AT&T Case's prohibition on BOC(s)' providing a "product or service that is not a natural monopoly service actually regulated by tariff". *AT&T Case*, 552 F. Supp. *supra*, at 187.

4. *See New York Telephone Company*, 5 F.C.C.R. 866 (1990) (initiating enforcement action) at 5 F.C.C.R. 5892 (1990) (settlement including refund); J.A. 83-84 (Am. Compl. ¶ 30) (FCC Proceeding); J.A. 79 (Am. Compl. ¶ 16) (referring to PSC proceedings resulting in direction to NYNEX that MECo's activities for the BOC(S) NYT and New England Telephone [NET] be transferred to an NYT-NET-owned subsidiary).

Other removal services suppliers referred to in the Amended Complaint, *i.e.*, McGee and LISN, were part of the conspiracy to monopolize. J.A. 111 (Am Compl. ¶ 107). J.A. 84-85 (Am. Compl. ¶ 33(a)).

B. The Court of Appeals' Decision

The Court of Appeals reversed in part and affirmed in part (Pet. App. 1a-20a) the District Court's dismissal of the Amended Complaint (Pet. App. 21a-52a). The Court of Appeals, respecting Discon's Section 1 claim, agreed with the District Court that because MECo could not be characterized as a supplier of removal services, Discon could not prevail on a theory of horizontal restraint of trade, on which theory Discon had "primarily" relied. Pet. App. 8a, 10a. In its reading of the Amended Complaint, the Court of Appeals determined that the pleadings stated a Section 1 cause of action under a legal theory different from that "articulated by Discon". Pet. App. 7a, 10a.

The Court of Appeals, with reference to *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 211-12 (1990), determined that an agreement between vertically related parties, such as between a single supplier and a single purchaser, could be described as an unlawful "group boycott" if the agreement's intent and effect was a "horizontal market impact". Pet. App. 10a-11a. The court, after noting that two-firm vertical combinations were generally "scrutinized as exclusive distributorship controversies, rather than a group boycotts" (Pet. App. 12a) (citing to *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 725-31 (1988)), determined Discon had stated a cause of action "under, at least, the rule of reason", and "possibly under the *per se* rule applied to group boycotts . . . , if the restraint of trade has no purpose except stifling competition." Pet. App. 13a.

The circuit court did not specifically identify any specific market affected by the alleged conspiracy of AT&T and the Petitioners to exclude Discon.[5] Also, the court did not identify a particular

5. The amended complaint itself states that the conspiracy sought "to exclude Discon from the market for removal services." J.A. 84 (Am. Compl. ¶ 33); J.A. 76 (Am. Compl. ¶ 3) referring to the conspiracy "to restrain trade in the market for (Cont'd)

anti-competitive effect of the alleged conspiracy.[6/]

Discon's Section 2 claim for conspiracy to monopolize was reinstated by the Court of Appeals. Pet. App. 14a. The court's reasoning was that the amended complaint sufficiently alleged that the Petitioners "conspired with "Technologies" and performed overt acts intending to assist [Technologies] in its monopolization of the market for removal services." Pet. App. 14a-15a. After noting that "to be liable for conspiracy to monopolize, it is not necessary that the [Petitioners] compete directly in the market for removal services." (Pet. App. 14a), the court determined that a party "may be liable for conspiracy to monopolize where it agrees with another firm to assist that firm in its attempt to monopolize the relevant market." *Id.*

SUMMARY OF ARGUMENT

The amended complaint sets forth a conspiracy, involving a competitor of Discon, to stifle and eliminate competition in the market for removal services in the State of New York and at central offices of NYT, which controlled almost 90% of local telephone services in the State of New York. This conspiracy was not, as some would have it, the mere changing of suppliers to lower cost and improve quality, but to eliminate competition in the unregulated removal services supplier market. It is a case for

(Cont'd)
removal services . . . purchased by telephone companies. . . ."; the acts to effect exclusion of Discon alleged to have occurred with respect to removal services being purchased by NYT directly or being provided through MECo. to NYT are also alleged. J.A. 84-92 (Am. Compl. ¶¶ 33-57).

6. Petitioners' assertion, that the Court of Appeals identified the anti-competitive effect of Discon's exclusion as overcharges of a regulated monopoly's rate-paying customers, is inaccurate. The Court of Appeals' comments concerned whether the Petitioners could present some pro-competitive justification "for choosing a more costly supplier in order to overcharge rate-paying customers, ..." Pet. App. 12a. The focus was on the supplier market and the amended complaint's allegations of the choice of Technologies over Discon being "entirely anti-competitive." *Id.*

7. The Court of Appeals reversed the District Court in finding there was sufficiently alleged a vertical conspiracy among NYNEX, MECo. And Technologies that contemplated discrimination against Discon. Pet. App. 7a n.3.

per se treatment as a blatant effort to control a market to benefit a competitor-conspirator.

A plea to protect a buyer's "freedom to replace one supplier with another" is unavailing in circumstances wherein the conspiracy alleged sought to suppress supplier interbrand competition in an unregulated competitive supplier market and thereby avoid the benefits of lower costs and prices, subsequently permitting the passage of the increased prices to captive ratepayers by the regulated monopolist participating in the conspiracy. The anti-competitive effect of the conspiracy was the suppression of competition in the unregulated removal services supplier market by the exclusion of Discon. The relevant market affected was controlled, both in access thereto and exclusion therefrom by one of the parties to the vertical agreement between one of the Petitioners and its supplier who dominated the supplier market. The conspirators themselves, by their conduct, gave shape to the relevant market.

The Court of Appeals concluded that a vertical agreement between a firm and its supplier to exclude a competing supplier may be treated as a "group boycott", addressable both under the rule of reason and the *per se* rule if the "restraint of trade has no purpose except stifling competition". The Second Circuit was well-justified in its analysis, because the amended complaint admits of no pro-competitive justification. There has been no discovery to date and thus no proof offered by the parties. The Court of Appeals observed that the traditional rationale for applying the rule of reason to two-firm group boycotts, promoting interbrand over intrabrand competition, was absent.

This Court has long observed that some type of restraints have predictable and pernicious anti-competitive effects, and such limited potential for pro-competitive benefit, they are deemed unlawful *per se*. *Northern Pacific R. Co. v. United States*, 356 U.S. 1, 5 (1958) "*Per se* treatment is appropriate '[o]nce experience with a particular type of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *State Oil Co. v. Khan*, 118 S. Ct. 271, 279 (1997), citing *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 344 (1982) and *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19, n.33 (1979).

This is because the character of the restraint produced by behavior to which a *per se* rule applies suffices for presuming unreasonableness without analysis of the market context in which the behavior occurs. *Eastman Kodak v. Image Technical Services*, 504 U.S. 451, 486-87 (1992) (Scalia, J., dissenting) citing *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 9 (1984). The Court is reluctant to adopt *per se* treatment of restraints imposed in business relationships where their "economic impact . . . is not immediately obvious." *State Oil Co.*, 118 S. Ct. at 279, citing *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 458-459 (1986). The primary purpose of anti-trust laws is to protect interbrand competition. *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 726 (1988). There is, in the context of the amended complaint, no attack on pro-competitive practices resulting in lower prices (or other procompetitive benefits) as was frowned on by the Court in *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986), cited in *State Oil Co.*, 118 S. Ct. at 282.

The Court of Appeals noted that the traditional rationale for the rule of reason's application, promotion of interbrand over intrabrand competition does not exist in this case. Pet. App. 13a. The courts have had prior experience with conduct similar to that in the present case, wherein boycott conduct and control by regulated telephone companies of supplier markets resulted in the AT&T Case consent decree respecting the Bell System breakup.

The history of AT&T control over the BOC(s), and its ability to thereby prevent competition at various levels, through its vertically integrated monopoly, resulted in a general prohibition against provision of products or services not a natural monopoly service actually regulated by tariff. *AT&T Case*, 552 F. Supp. at 186-187. While the consent decree was, by its terms, not to have *prima facie* effect in private litigation, *AT&T Case*, 552 F. Supp. at 210-211, the aforesaid prohibition was certainly intended to address conduct such as that in the present case, wherein MECo., acting as a "gatekeeper", of the unregulated supplier market, sought to stifle or exclude competition in that market by exclusion of Discon for Technologies' benefit. The conspiracy in the present case, a vertical agreement to stifle interbrand competition, merits *per se* treatment.

Petitioners seek to present the issue of whether Discon has stated a Section 1 claim in the context of a rule of reason analysis. (Pet. Br. 27-39). The issue is not merely complimentary to, or fairly within, the question presented. However, should the Court so find the issue properly before it, Discon has properly alleged a claim under the rule of reason. The Amended Complaint alleges competitive harm, the relevant market and the conduct complained of in a detailed manner. The conduct challenged is of a type condemnable under a "quick look" rule of reason analysis.

A conspiracy by two firms to monopolize a market was properly held by the Court of Appeals to violate Sherman Act § 2, although only one of the conspirators competed in that market, as long as the other conspirators agreed to assist the competing conspirator in its attempt to monopolize the relevant market. Pet. App. 14a-15a. The gravamen of the alleged violation is that a conspiracy was entered into by two or more parties sharing an intent to create or maintain monopoly power by improper means. *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 612 n.1 (1977).

Petitioners' observation that it is "implausible" that they would assist AT&T in obtaining monopoly power is not borne out in theory or fact. Regulatory avoidance activity involves a profit motive that can induce regulated monopolists to engage in anti-competitive conduct such as effecting exclusion or suppression of competition in unregulated supply markets. It was precisely this profit motive on which the Court of Appeals focused, finding in the amended complaint allegations that Petitioners' motive in helping AT&T obtain monopoly power involved excluding competing removal services suppliers that threatened Petitioners' scheme to evade regulation. Petitioners' benefits from regulatory evasion could well outweigh costs to Petitioners if AT&T attained monopoly power in the supplier market.

Petitioners have also sought to raise issues without the scope of this Court's grant of certiorari on the questions of whether a vertical non-price agreement between "a [p]urchaser" and its "[s]upplier" could "be characterized as a conspiracy to monopolize." Pet. Br. i. Petitioners' argument that the Section 2 claim should be dismissed due to certain alleged pleading deficiencies is not properly before the Court. The pleadings properly stated a claim under Section

2, and the Court is requested to so find in the event the issue is determined to be properly before the Court.

ARGUMENT

This case comes before the Court on a motion to dismiss. In such a context, the Court assumes the facts alleged in the amended complaint can be proven. All factual inferences must be drawn in the plaintiff's favor and against defendants. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). While the lower courts retain power to insist on "some specificity in pleading before allowing a potentially massive factual controversy to proceed [,]," *Associated Gen. Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 528 n.17 (1983), this Court has reaffirmed that the liberal system of notice pleading applies to all causes of action unless otherwise specified in the Federal Rules of Civil Procedure. *Leatherman v. Tarrant County Narcotics Intelligence and Co-ordination Unit*, 507 U.S. 163, 163-65 (1991). Persistent efforts by anti-trust defendants to seek application of a heightened pleading standard in anti-trust cases have been determined to conflict with *Leatherman*, *id. MCM Partners v. Andrews — Bartlett & Assocs.*, 62 F.3d 967, 976 (7th Cir. 1995); *Hammes v. AAMCO Transmissions, Inc.*, 33 F.3d 774, 778, 782 (7th Cir. 1994). Pre-*Leatherman* cases are of like effect. *See, e.g., Quality Foods de Centro America, S.A. v. Latin American Agribusiness Dev. Corp.*, 711 F.2d 989, 995 (11th Cir. 1985) (notice pleading is all that is required for anti-trust complaint); *George C. Frey Ready-Mixed Concrete, Inc. v. Pine Hill Concrete Mix Corp.*, 554 F.2d 551, 554 (2d Cir. 1977).

The movants, herein the Petitioners, must demonstrate, "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); accord, *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984) (quoted in *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 250-51 (1989)). A complaint need contain either direct or inferential allegations respecting the "material elements necessary to sustain recovery under some viable legal theory." *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1106 (7th Cir. 1984), *cert. den.*, 470 U.S. 1054 (1985).

I.

THE COURT OF APPEALS PROPERLY CONCLUDED THAT A VERTICAL AGREEMENT TO EXCLUDE A COMPETING SUPPLIER MAY BE A *PER SE* UNLAWFUL GROUP BOYCOTT.

The Court of Appeals' held that a valid claim had been stated under Sherman Act § 1, at least under the rule of reason, "and possibly under the *per se* rule applied to group boycotts in *Klor's*, if the restraint of trade 'has no purpose except stifling competition.' " Pet. App. 12a-13a. The traditional rationale for the rule of reason's application, promotion of interbrand competition over intrabrand competition, was stated not to exist in this case. Pet. App. 13a, n.6. The Second Circuit's holding was correct, addressing, as it did, the Petitioners' conduct in the stifling of competition in an unregulated removal services market. It is this conduct which the amended complaint addressed.

A. The "Group Boycott" *Per Se* Analysis is Applicable To The Present Case.

In analyzing challenged conduct to determine the existence of a *per se* violation, the Court has focused on whether the conduct challenged, in a functional sense, has a balance of harm and virtue that is predominantly harmful. The Court has identified the critical inquiry as whether the practice in question facially appears to be one "that would always or almost always tend to restrict competition and decrease output, and in what portion of the market . . .[,]", basically a "naked restrain[t] of trade with no purpose but stifling of competition. . . ." *Broadcast Music v. CBS (BMI)*, 441 U.S. 1, 19-20 (1979).

The label applied to the Petitioners' conduct by the Second Circuit, with reference to *per se* analysis, was "group boycott". That term does not have an absolute meaning. As one treatise observes, "Courts often ask themselves whether they should 'extend' a *per se* rule to cover conduct with some 'boycott' or price fixing attributes". VII P. Areeda, *Antitrust Law* ¶ 1510c. Another observes that "[t]here is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the

per se doctrine." L. Sullivan, *Law of Antitrust* 229-230 (1977). This Court has commented that "Exactly what types of activity fall within the forbidden category is, however, far from certain[,]" and that "Some care is therefore necessary in defining the category of concerted refusals to deal that mandate *per se* condemnation." *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 286, 294 (1985), citing *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 543 (1978) (concerted refusals to deal "are not a unitary phenomenon").

In the present case, the Petitioners and AT&T conspired to exclude Discon from competing in the removal services market. The Court of Appeals characterized the conduct alleged in the Amended Complaint as a vertical non-price agreement intended to disadvantage one of the conspirators' direct competitors. Pet. App. 10a-11a.[8]

This Court has commented that the *per se* approach has generally involved

> joint efforts by a firm or firms to disadvantage competitors by "either directly denying or persuading or coercing suppliers or customers to deny the relationships the competitors need in a competitive struggle."

Northwest Stationers, 472 U.S. at 294 (citations omitted).

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8. The Court of Appeals' applied *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) to determine that MECo.'s acts at the behest of NYNEX and NYT were "guided by a single corporate consciousness" and thus it was not a separate conspirator under the doctrine disavowing Section 1 intracorporate conspiracy. Pet. App. 9a-10a. Due to the stage of the present case, there having been no discovery, it is not yet ascertainable whether MECo.'s creation was, of itself, part of a scheme to control supplier markets for removal services. If so, the *Copperweld* decision itself suggests this conduct would be subject to Section 1 scrutiny because the creation of the entity itself (MECo.) and not its post-creation conduct would be evaluated, i.e., a combination to restrain trade. *Cf.*, 467 U.S. at 773-774 & n. 23. Such conduct is addressed in the Amended Complaint (Am. Compl. ¶¶ 17, 24 and 25) concerning the Eckenrode Synergy Plan and the creation of MECo. by AT&T and transfer of MECo. to NYNEX as a result of the AT&T Case.

> In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete, [citations omitted], and frequently the boycotting firms possessed a dominant position in the relevant market.

Id. (Citations omitted). Practices assailed in *per se* cases were not supported "by plausible arguments" concerning enhancement of "overall efficiency" and making "markets more competitive." Such cases had a clear likelihood of anti-competitive effects and remote possibility of countervailing effects. *Id.*

Petitioners' argue that, historically, the *per se* group boycott label is affixed to situations in which agreements among the complainant's competitors at the same level of distribution were the subject of condemnation. Pet. Br. 17, citing *Business Electronics* at 734, and other cases. From this follows that absent some agreement among a complainant's horizontal competitors only a rule of reason analysis need be had as the agreement attacked is vertical. The problem, as the Second Circuit has observed, is that the traditional rationale for the rule of reason's application in this case is absent, as the conduct alleged stifled and suppressed interbrand competition. Pet. App. 13a. In this context, the question is posed as to whether a group boycott label is applicable to an agreement between a purchaser of services and a competitor of the complainant to force the complainant from the relevant market by engaging in a series of overt acts to accomplish that goal. Petitioners would have the Court apply *per se* group boycott analysis only to certain horizontal arrangements. The criteria on which the Court has historically relied calls for a different result.

The Court has, in *Business Electronics*, 485 U.S. at 735-36, stated that "economic analysis supports the view, and no precedent opposes it, that vertical restraint is not illegal *per se* unless it includes some agreement on price or price levels". This conclusion was reached in the context of review of prior Court decisions which evaluated vertical arrangements with an eye to promoting interbrand over intrabrand competition and for preserving the former. In *GTE Sylvania*, for instance, the Court indicated that a *per se* rule in the context of vertical non-price location restraints was unneeded because

such were not needed or effective to protect intrabrand competition, but had real potential to stimulate interbrand competition. 433 U.S. at 51-52. In *Business Electronics*, the Court applied the GTE Sylvania rationale to a price-cutter's dealership termination as the result of the manufacturer's agreement with another dealer, as a plausible purpose of the agreement was to enable the remaining dealer to provide better services under its sales franchise agreement. In *State Oil*, 118 S. Ct. at 282, the Court found it "difficult to maintain that vertically-imposed maximum prices could harm consumers or competition to the extent necessary to justify their *per se* invalidation[,]" citing a portion of the Seventh Circuit opinion, under review, which explained pro-competitive effects of the practice.

If group boycott analysis desponded solely upon the horizontal relationship of conspirators to a complainant, then condemnation under group boycott analysis may be avoided simply by structuring vertically that which cannot be effected horizontally.

In the present case, MECo. was a "gatekeeper", determining by its power of vendor approval (under contract with NYT) who could compete in the provision of removal services to NYT. Existence of competitors of Technologies (AT&T) was a function of whom MECo. approved as vendors. Though Discon was approved by MECo., it was determined, as part of the conspiracy set out in the Amended Complaint, that Discon had to be excluded from the market for removal services to NYT and in the New York State area. J.A. 84-91 (Am. Compl. ¶¶ 31-56). The suppression of competition in the unregulated removal services market was effected by overt acts of MECo., AT&T, NYNEX, NYT and Technologies to implement the challenged vertical agreement. J.A. 84-91 (Am. Compl. ¶¶ 32-57). The two predominant buyers of removal services were involved, *i.e.* NYNEX and AT&T, as well as Discon's major competitor, Technologies. J.A. 82-83 (Am. Compl. ¶¶ 26, 29). Exclusion of Discon from the removal services market cut off Discon's access to NYT, a dominant purchaser of removal services.[9]

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9. A relevant market may be one to which access is sought, that is, foreclosed by the challenged conduct. In the present case, the Amended Complaint sets forth the overt acts to exclude Discon from the removal services market. *Cf., Fishman v. Estate of Wirtz*, 807 F.2d 520, 531-32 (7th Cir. 1986).

Where a competitor of the complainant conspires by vertical agreement with parties controlling the dominant purchasers of removal services, *i.e.* NYNEX (NYT) and AT&T (ATC), to effect through overt acts the exclusion of the complainant, there is not merely a choice of one supplier over another. In *Klor's v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 209-210 (1959), Broadway-Hale, the owner of a chain of department stores, used what the Court described as its "monopolositic buying-power" as a means of convincing several appliance manufacturers not to deal with Klor's, a small single outlet retail competitor. Rather than concentrate its buying power to obtain the lowest possible price from the manufacturers, Broadway-Hale exacted agreement not to sell to Klor's, its competitor. This practice was held to violate the Sherman Act, and the opinion can be regarded as declaring group boycotts *per se* illegal.

In *Business Electronics*, 485 U.S. at 734, the Court chose to characterize its Klor's decision as involving a horizontal combination at the manufacturer/distributor level although the party inducing the conduct against its competitor through its monopsonistic power was, as is Technologies (AT&T), the beneficiary of the condemned conduct at another market level. The *Business Electronics'* treatment of *Klor's* has been termed a "reinterpretation" of *Klor's* by commentators analyzing the case from a monopsony perspective. R.D. Blair and J.L. Harrison, *Monopsony-Antitrust Law and Economics* 79 & n.57 (1993).[10]

Klor's and the present case are similar in that the defendant, Broadway-Hale, although only vertically related to its other conspirators, sought to eliminate a competitor, which was the conduct condemned by the Court. *Klor's*, 359 U.S. at 213. The

10. "Group boycotts" do not require boycotters and the ultimate target to be in competition with each other. That only one competitor of the harmed party participates is sufficient. Historically, enlistment of third parties in an agreement not to trade, as a means of compelling surrender by the boycott target, has long been viewed as supporting a finding of unlawful boycott. Various boycott forms are discussed in *St. Paul Fire & Marine Insurance Co. v. Barry*, 438 U.S. 531, 541-47 (1978), without reference to whether the boycott conduct was *per se* unreasonable. It appears Blair and Harrison read *Klor's* focus to be on the participation of a competitor in boycott conduct through its abuse of purchasing power to force participants in a vertically-related market not to trade with its retail competitor.

Court, though referencing Klor's allegations of "a wide combination consisting of manufacturers, distributors and a retailer", focused on deprivation of Klor's freedom to buy appliances in an open, competitive market, and the deprivation of the manufacturers' and distributors' freedom to sell to Klor's on the same terms available to Broadway-Hale, and in some cases prohibiting sales. *Id.* The present case presents a vertical agreement whose goal was the exclusion of a competitor. As in *Klor's*, there appear no pro-competitive justifications, such as efficiencies. *Klor's*, 359 U.S. at 210 (the defendants' affidavits provide no defense); Pet. App. 12a (no pro-competitive justification appears on the face of the complaint). *See also* R.H. Bork, *The Anti-Trust Paradox: A Policy At War With Itself* 332 (1978) (In antitrust terms, *Klor's* explained by the boycott having no possibility of efficiency and deprived customers of an outlet).

This Court's identification of *per se* violations as those having a "pernicious effect on competition" and lacking redeeming value are apposite here. *Northern Pacific R. Co.*, 356 U.S. at 5. As with *Klor's*, the goal of the vertical agreement in this case was the elimination of a competitor with no pretense of benefit to intrabrand or interbrand competition.[11] The Sherman Act does not distinguish between horizontal and vertical agreements or conspiracies to eliminate competitors. Concerted conduct by vertically arrayed parties is certainly susceptible of damaging markets wherein each participant competes. If a "group boycott" concerns enlistment of a third party or parties in an agreement not to trade, more than one participant at a particular market level is unnecessary where the agreement not to trade has as its object the elimination of a competitor of a party to the agreement. Such conduct suggests *per se* rule application as competitive damage occurs in both supplier and purchaser markets where a competitor is sought excluded. Under such circumstances, Petitioners' conduct is patently anti-competitive and should be permitted analyzed as the Court did in *Klor's*, as a *per se* violation.

11. The vertical agreement in this case, with its goal of eliminating Discon as a competitor represents conduct of a pernicious type that lacks any offsetting legitimate objective. Such conduct is amenable to application of *per se* analysis. That a *per se* analysis may be a category or "special case of the rule of reason" does not undermine the analogizing of the present case to *Klor's*. *Cf.*, IIIA P. Areeda and H. Hovenkamp, *Antitrust Law* ¶ 1509 at 413-414 (Rev. Ed. 1996).

B. Petitioners Rule of Reason Arguments on the Section 1 Claim Should Not Be Considered.

Certiorari was granted by the Court on whether the Court of Appeals erred in characterizing as a "group boycott" the agreement alleged by Discon. Pet. i; Petr. Br. i. Petitioners devoted a substantial portion of their argument to the proposition that Discon has failed to state a claim under the rule of reason. Petr. Br. 22-39. The content of the rule of reason analysis by Petitioners itself suggests the rule of reason question is elementally different from, and not "fairly included" within the question presented. *Izumi Seimitsu Kogyo Kabashiki Kaisha v. U.S. Philips Corp.*, 510 U.S. 27, 30-32 & n.5 (1993) (*per curiam*). Although the rule of reason question may be related to the question presented in the petition for certiorari, it is not fairly included therein. *Id.* at 31-32. Petitioners now advance questions and arguments that they did not raise or address below. The "regulatory evasion" argument advanced by Petitioners, characterizing Discon's claim as regulatory fraud masquerading as an anti-trust case, does not appear to have been advanced in such form until Professors Areeda and Hovenkamp published their commentary subsequent to argument in the Court of Appeals. P. Areeda and H. Hovenkamp, *Antitrust Law* ¶ 1644'c at 726-28 (Supp. 1997). In this circumstance, *Izumi Seimitsu's* application is called for.

In the event the Court desires to consider the rule of reason arguments advanced by Petitioner, the Respondent's response is set forth below.

C. Discon Has Stated A Cause of Action Under Section 1 of the Sherman Act Regardless of Whether A *Per Se* or Rule of Reason Analysis Applies.

The Second Circuit clearly stated that Discon had stated a claim under the rule of reason, and , if the vertical agreement challenged had no purpose except stifling competition, a *per se* analysis could apply. Pet. App. 12a-13a n.6. The Petitioners, by ignoring the Court of Appeals' reference to the rule of reason, and the analysis in that court's opinion, assert a conclusion that its decision ignored requisite allegations and "proof of harm to competition". Petr. Br. 19-20. Reference to the Court of Appeals' analysis of the Amended Complaint addresses most of the Petitioner's concerns.

As early as 1923, the Court, through Justice Holmes, articulated the standard for dismissal of an antitrust claim on the pleadings. A court must be "prepared to say . . . at least that the claim is wholly frivolous." *Hart v. B.F. Keith Vaudeville Exchange*, 262 U.S. 271, 274 (1923). "[D]ismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly." *Hospital Building Co. v. Trustees of Rex Hospital*, 462 U.S. 738, 746 (1976). Even in a post-discovery context, summary procedures are frowned on in antitrust litigation "where motive and intent play leading roles [and] the proof is largely in the hands of the alleged conspirators." *Poller v. Columbia Broadcasting System*, 368 U.S. 464, 472-73 (1962). These principles apply to anti-competitive intent and to any other challenged element of a Sherman Act claim. *McLain v. Real Estate Board of New Orleans*, 444 U.S. 232, 246-47 (1980).

1. *Allegations of Harm to Competition*

This Court has repeatedly expressed that the Sherman Act protects competition, not competitors. *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 488 (1977), citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). Thus, injury may not be claimed from preservation of competition in the market, as this is inimical to the anti-trust laws. *Brunswick Corp.*, 429 U.S. at 488 (the injury complained of resulted from increased competition).

While there has not been a precise definition by the Court of "competition",

> [t]he Court has observed that a restraint's effect on competition depends on whether the restraint increases or decreases output, which in turn affects the market price.

ABA Section of Antitrust Law, *Antitrust Law Developments* 54 (4th ed. 1997) (footnote references omitted); *N.C.A.A. v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 99-100 (1984); *Broadcast Music, Inc.*, 441 U.S. at 19-20; *United States v. Brown Univ.*, 5 F.3d 658, 668 (3d Cir. 1993). Courts have accepted

> three distinct methods of establishing the requisite anticompetitive effect: (1) proof of a "naked" restraint whose adverse competitive effect is so obvious that the

> quick look rule of reason should be applied, (2) proof of actual anticompetitive effect, and (3) market analysis that indicates the restraint will create or facilitate the exercise of market power.

ABA Section of Antitrust Law, *Antitrust Law Developments* 56 (4th ed. 1997). The foregoing, while speaking to proof or establishment of anticompetitive effect, provides a background for evaluating the Amended Complaint.

Petitioners are alleged, in the Amended Complaint, to have conspired with Technologies and AT&T to effect exclusion of Discon as a competitor in the removal services market for NYT central office exchanges and in New York State. J.A. 76 (Am. Compl. ¶ 2); J.A. 82-92 (Am. Compl. ¶¶ 26-63). Each of the lower courts in this case interpreted the Amended Complaint as alleging a conspiracy whose goal was to eliminate Discon entirely as a seller of removal services. Pet. App. 24a (District Court), 4a (Court of Appeals); but *cf.*, Pet. App. 28a (District Court treats as agreement between NYNEX and AT&T to "exclude Discon from NYT's removal service and to award scrap removal service contracts to Technologies instead.")

Overt acts against Discon by the conspirators, to effect Discon's exclusion from the removal services market, reflected the conspirators' goal that Discon was to be eliminated. The effect was an increase in prices in the removal services market. That there were substantial price increases once Discon was eliminated is seemingly without debate, at least as far as the public record reflects in proceedings before the FCC and N.Y. PSC.[12] There has been a clear allegation, and a preliminary showing, that the exclusion of Discon was accompanied by concurrent and subsequent price manipulation as between Technologies (AT&T) and MECo. J.A. 90 (Am. Compl. ¶ 51).

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12. In December of 1988, MECo. agreed with the New York PSC to a partial refund of $42.2 million relating to intrastate overcharges. The FCC made findings that MECo.'s conduct (although the FCC's jurisdiction over MECo. was strongly contested) resulted in NYT's paying inflated prices for goods and services, an unreasonable practice in violation of the Communications Act of 1934, 47 U.S.C. § 201(b). NYT then paid the largest fine (to that time) in FCC history and agreed to make refunds and adjustments to its rate base. J.A. 94-95 (Am. Compl. ¶¶ 65-67). *See also New York Telephone Co.*, 5 F.C.C.R. 866, 5892 (1990).

Whether the Amended Complaint is treated as alleging a conspiracy to eliminate Discon from the removal services market, or, as the government has argued, that an agreement in facilitation of regulatory fraud is an antitrust violation, the effect is the elimination of a competitor and, consequently, elimination of competition. *See* Brief for the United States and the Federal Trade Commission on Petition for Certiorari at 7-11.[13] No procompetitive effects have been suggested or offered by Petitioners; Petitioners would be required to advance such justification as the facts in the Amended Complaint being assumed true.

2. *The Relevant Market — "The Illusion of Competing Sellers"*

Petitioners have stated that to condemn an agreement as anti-competitive, it must make purchasers worse off by limiting the overall range of existing, as well as potential sellers, or their ability to compete, so as to subject purchasers to reduced output and increased price. From this, it is concluded that Discon

> must make allegations from which reasonable inferences may be drawn-that the agreement has harmed . . . marketwide competition to the detriment of the buyers in that market.

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13. Petitioners would have the Court treat this case as one of regulatory fraud, citing P. Areeda & H. Hovenkamp, *Antitrust Law; An Analysis of Antitrust Principles and Their Application* ¶ 1644'c (1997 Supp.), who treated this case as one of fraud because they believe the conduct involved presented no danger of monopoly. The analysis is at odds with an observation in the same treatise that anti-trust intervention is appropriate only when "(1) the regulatory agency is not the effective decision maker, and (2) the conduct really threatens the competitive vigor of a vertically or collaterally related market". IIIA P. Areeda and H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 787 at 284-85. The regulatory action of the FCC and PSC may have addressed the correction of over-charges incorporated in NYT's regulated rate base, but there is no pretense that such regulators could remedy the damage done to competition in the removal services market. NYNEX's response was, in the face of a PSC audit, to take in-house its procurement functions to enable NYT to contract directly with removal service suppliers. J.A. 92 (Am. Compl. ¶ 58). This is another recognition that the removal services market competition had been damaged by the Petitioners, as NYT had recognized that Discon was, in fact, the lower priced, more efficient competitor. J.A. 86-92 (Am. Compl. ¶¶ 38, 39, 40, 41, 42, 43, 51 and 57).

Pet. Br. 22-23. As Petitioner notes, this approach is often formulated as a requirement of proof of actual or threatened market power. *Id.* At 22, n.17.

Revisiting the Amended Complaint, Discon alleged therein that MECo. was created as a purchaser of services and goods and was, in fact, engaged by NYT to handle about 90 per cent of NYT's projects requiring removal services.[14] J.A. 83 (Am. Compl. ¶ 27). NYT and ATC were alleged to be the dominant purchasers of removal services in the "New York State" area. J.A. 83 (Am. Compl. ¶ 29). Technologies was the sole supplier of removal services for ATC, and its predecessor, Western Electric, performed virtually all removal services at NYT central exchange offices. J.A. 82-83 (Am. Compl. ¶ 26). Subsequent to January 1, 1984, NYT was the dominant exchange carrier in New York State, serving every town and city whose population exceeded 25,000 except for Rochester, Jamestown and Middletown. As of December 31, 1989, NYT served about 90 percent of all network access lines in the State, and supplied more than 95 per cent of exchange service and access. J.A. 81 (Am. Compl. ¶ 23).

MECo., through its authority to approve and engage vendors to provide services had, practically speaking, the authority to control competition within the removal services market in New York State for NYT, the overwhelmingly dominant local service provider and removals purchaser. ATC was serviced solely by Technologies, and there is no indication that independents were providing ATC with removal services. Discon has further alleged that MECo. and Technologies maintained at least an 80% market share for removal services in New York State. J.A. 110 (Am. Compl. ¶ 98).

MECo.'s power to approve vendors of services to NYT had the corresponding effect of restricting the vendors to whom NYT could turn, whether "existing sellers or new entrants." As alleged in

14. This occurred after NYT had first tried to do its own removal services work on 1% of the removals, and then administered bids itself only about 10% of the 400 removals. J.A. 83 (Am. Compl. ¶ 27). After these efforts, NYT contracted with MECo. *Id.*

the Amended Complaint, MECo., as part of the vertical agreement, engaged in a number of overt acts against Discon to further Technologies' dominant position as a provider of removal services, eventually leading to disqualification of Discon as a vendor. J.A. 84-91 (Am. Compl. ¶¶ 33(c, d, e), 34, 35, 37-43, 45-47, 49-55).

Rule of Reason analysis of Section 1 claims requires the trier of fact to delineate the "relevant market". A relevant market is comprised of those "commodities reasonably interchangeable by consumers for the same purposes. . . ." *United States v. E.I. DuPont deNemours & Co.*, 351 U.S. 377, 395 (1956). The proper market definition is usually determined only after a factual inquiry into the "commercial realities" faced by consumers. *United States v. Grinnell Corp.*, 384 U.S. 563, 572 (1966).

The measure of market power under Section 1 is something less than the monopoly power under Section 2. *Eastman Kodak Company v. Image Technical Services, Inc.*, 504 U.S. 451, 481 (1992). In the present case, MECo., approving vendors, and hence their services, controlled NYT's access to the removal services market, and conversely, the suppliers' access to NYT.[15] Stated otherwise, the effect of the NYNEX conspiracy with AT&T and Technologies was to deprive NYT of choice, by excluding Discon, with a corresponding impact on price, that is the ability to charge supracompetitive prices, indicating market power. *See, e.g., NCAA v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 109 n.38 (1984). There has been no proffer of facts by the Petitioners that there was

15. The Court has recognized that, with respect to Section 2 monopolization and attempt to monopolize cases, the definition of the relevant market may involve analysis of submarkets that are separate economic entities. *Grinnell*, 384 U.S. at 571-72, citing *Brown Shoe*, 370 U.S. at 325. Thus, the relevant market may be removal services for NYT exchange facilities, or for the New York State area. In the context of MECo.'s conduct, this would be an issue to be determined after discovery. Presently, it is sufficient to refer to markets, at the pleading stage, that are susceptible of proof. *MCM Partners*, 62 F.3d at 977, citing *Conley v. Gibson*, 355 U.S. at 45-46.

any other provider choice available to the dominant purchasers of removal services in the New York State market.[16]

NYT's overwhelming presence in local telephone service (about 90% of exchange service access), combined with Technologies servicing of all ATC requirements and its effecting of its dominance in serving NYT needs created an unusual combination of monopsony buyer (MECo.) power and Technologies' dominance indicating monopoly strength. MECo.'s control of vendor approval (acquisition of services) and Technologies' dominance over provision of removal services to NYT and in New York State may well meet the Court's test for monopoly power — "When a product is controlled by one interest, without substitutes available in the market, there is monopoly power." *DuPont*, 351 U.S. at 394. Petitioners conspired with AT&T and Technologies to exclude Discon from the market, with the "existence" (availability) of suppliers, if any, controlled by MECo. and Technologies. *Cf.*, *United States v. Grinnell Corp.*, 384 U.S. at 571 (87% of the market is a monopoly); *American Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946) (over two-thirds of market is a monopoly).

MECo.'s control of the purchaser market and approval of suppliers thereto, and the dominance by Technologies in the supplier market sought furthered by the conspiracy, meet the criteria for pleading of actual or threatened market power. The effect of this power was to facilitate MECo.'s use of high cost vendors, (*i.e.*, Technologies) in lieu of extreme markups by MECo. to historic Western Electric service costs, by suppressing or excluding low cost vendors (as Discon) in the services market, despite the objections of NYT to the extreme mark-up conduct. J.A. 90 (Am. Compl. ¶ 51). Petitioners should not be permitted to seek a relevant market

16. Technologies agreed with MECo. to serve as a subcontractor of MECo. for most removal services contracts, and MECo. agreed to award Technologies most contracts on a non-competitive basis. J.A. 84 (Am. Compl. ¶ 31). Other than Discon and Technologies, there was one nominal removal service supplier approved by MECo. (LISN), but these were not known others to have been so approved. Even if such suppliers existed, their ability to obtain services contracts was subject of MECo.'s "gatekeeper" powers. Also, supracompetitive prices were charged by Technologies to MECo. once NYT objected to MECo.'s abusive markups, by MECo.'s use of the higher cost vendor. J.A. 90 (Am. Compl ¶ 51).

broader than that their conspiracy sought to create by exclusion of Discon to effect Technologies' complete dominance of the removal services supplier market. The conspiracy (vertical agreement) itself focused on exclusion of alternative competing suppliers of services, making their hypothetical availability practically irrelevant. To aver that NYT might supply its own services or to bid them out itself is not substantiated by the uncontroverted pleading challenged herein, as NYT had put its fate in MECo.'s hands. J.A. 83 (Am. Compl. ¶ 27).

This Court has observed that dismissal on pleadings should rarely be granted in anti-trust conspiracies because "proof . . . is usually in the hands of the co-conspirators." *Hospital Building Co. v. Trustees of Rex Hospital*, 462 U.S. at 746. The Amended Complaint identified the co-conspirators and described the "nature and effect" of the Section 1 conspiracy. *General Electric Co. v. Bucyrus-Erie Co.*, 563 F. Supp. 970, 975 (S.D.N.Y. 1983). The "nature and effect" of the alleged conspiracy was to effect the exclusion of a competitor from, and thus lessen competition in, the market for removal services. J.A. 112 (Am. Compl. ¶ 110), J.A. 82-92 (Am. Compl. ¶¶ 26-57). The co-conspirators are identified. J.A. 78-80, 82-92 (Am. Compl. ¶¶ 14-19, 25-57), and various overt acts in implementing the conspiracy (and hence the vertical agreement challenged) were alleged in substantial detail though no discovery has occurred. J.A. 84-92 (Am. Compl. ¶¶ 31, 33-39, 41, 46, 47, 49-51). Because a review of the impact on the market will show an unreasonable exclusion of Discon, the vertical agreement, as an integral part of the conspiracy, will not pass muster under Rule of Reason analysis as a non-price vertical restraint. *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 761 (1984), citing *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977).

Discon has properly alleged the elements of a Section 1 conspiracy, respecting the vertical agreement at bar. A relevant market has been identified, shaped by the acts of MECo., a party to the agreement, by exclusion of a competitor, Discon, to enhance the dominance of Technologies in that market, as well as in the New York State market, in which the conspirator competitor Technologies had a market share of at least 80%. Thus, Technologies, Discon's

competitor is alleged to have and did benefit from the inhibition of competition.

3. *The Involvement of Regulated Monopolies Does Not Affect Antitrust Enforcement Respecting Unregulated Markets.*

Petitioners repeatedly refer to the need for freedom to make efficient changes of suppliers or to enter into efficiency-enhancing requirements agreements. Petr. Br. 26-27. No procompetitive justifications have been advanced by Petitioners, making references to efficiency-justified actions theoretical in the present posture of this case.

Petitioners suggest that regulated utilities' involvement in the conspiracy lessens the need for antitrust scrutiny. Petr. Br. 27. This is a diluted version of the argument rejected in the *AT&T Case*, 552 F. Supp. at 156-157, and in preceding actions, wherein the District Court observed that regulation under the federal Communications Act "is neither sufficiently explicit nor sufficiently pervasive to allow it to stand in the way of the antitrust laws." (footnotes omitted). *See also United States v. American Tel. And Tel. Co.*, 524 F. Supp. 1336, 1345 (D.D.C. 1981); *United States v. American Tel. And Tel. Co.*, 461 F. Supp. 1314, 1320-30 (D.D.C. 1978). Similar arguments about state utility regulation have been made and similarly rejected. *AT&T Case*, 552 F. Supp. at 156-59.

In *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 593-96 (1976), this Court stated, in a regulated utility context wherein the utility provided free replacement bulbs to its customers, that where a state-regulated entity became involved "in an essentially unregulated area such as the market for electric light bulbs" the existence of state regulation would not foreclose antitrust law enforcement. *Id.* at 595.

In *Cantor*, the Court advised that public utility regulation assumes "the private firm is a natural monopoly and that public controls are necessary to protect the consumer from exploitation[,]" and then stated

> There is no logical inconsistency [between requiring a firm to satisfy regulation when exercising natural monopoly powers] and also to comply with antitrust

> standards to the extent it engages in business activity in competitive areas of the economy.

428 U.S. at 596.

Petitioners have not asserted that the removal services market was regulated. MECo. was unregulated and was dealing with unregulated service vendors. Discon's claim is that it was excluded from the unregulated removal services market and that competition was thereby harmed. There should be no less antitrust concern, because certain conspirators were regulated in their natural monopoly functions, when Discon was excluded from an unregulated suppliers market.[17]

D. Competitive Harm Alleged By Discon Was Its Exclusion From The Unregulated Supplier Markets.

The Second Circuit was concerned with the exclusion of Discon from the removal services market. This was the case for both Sherman 1 (Pet. App. 4a) and Sherman 2 (Pet. App. 15a) claims, as the Court of Appeals interpreted the Amended Complaint. Petitioners argue that the Second Circuit "relied on the claim of regulatory evasion as itself establishing competitive harm[,]" Petr. Br. 27-28, and thereby confused harm to ratepayers of the regulated monopoly conspirator with harm in the alleged markets for removal services, "the only markets where competition is even claimed to be restrained." Petr. Br. 28. Petitioners' comments acknowledge that the removal services markets are identified in the Amended Complaint as the subject of the vertical restraint at issue.

The relevant market has been created, in material part, by MECo.'s own conduct, MECo. having been granted by contract the power to approve vendors and let contracts for provision of services and products to NYT. J.A. 83 (Am. Compl. ¶ 27). MECo. was not

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17. The Court of Appeals treated MECo. as unified with NYT and NYNEX due to application of the *Copperweld* principle that a parent and a subsidiary cannot conspire for Sherman 1 purposes. Pet. App. 9a-10a. *Copperweld's* application should not be permitted to vitiate the *Cantor* analysis as to the applicability of antitrust in non-regulated markets, particularly where one of the "unified" conspirators was the unregulated MECo.

regulated by either the FCC or N.Y. PSC, both of which focused their regulatory efforts on remedying the rate base effects arising from the stifling of competition in the unregulated supplier market. J.A. 94 (Am. Compl. ¶¶ 65-67).

MECo. did not provide regulated services, nor did it file tariffs or otherwise seek regulatory approval for its activities. Rather, MECo. was established for, as well as operated, in markets beyond regulatory control, and the Amended Complaint so alleges. J.A. 82 (Am. Compl. ¶¶ 24-25). Compare, *AT&T Case*, 552 F. Supp. at 186-187 (BOC(s) not to provide any product or service not a natural monopoly service regulated by tariff).

The Court of Appeals' language speaks of the lack of justification of Petitioners' choice of Technologies over Discon in the removal services market. Pet. App. 12a. Petitioners interpret the Second Circuit's comment that the Petitioners might advance a pro-competitive justification for more costly supplier choice to permit overcharging of rate-paying customers as indicative that the harm being addressed was to the ratepayer. Petr. Br. 28. The conduct being focused on is the choice of supplier in the removal market and the justification therefor. Relevant market considerations being addressed are those in the removal services market. Petitioners confuse the Court of Appeals' observation on potential justification for their actions with the market in which they are causing damage.

Petitioners' argument is merely an expansion on the comments of Professors Areeda and Hovenkamp that the present case presents an issue of regulatory fraud, because, purportedly, there was no threat of monopoly. Areeda & Hovenkamp, *Antitrust Law* ¶ 1644'c (Supp. 1997). Such analysis of this case was, as noted above, in conflict with the same authors' observations that in the context of regulated monopolies, antitrust concerns are a particular problem in the context of monopoly or near monopoly in the supplier market. IIIA Areeda and Hovenkamp, *Antitrust Law* ¶ 787(b).

Antitrust policy is particularly implicated when a regulated monopolist, directly or indirectly, is involved in conspiracies that impact competition in an unregulated market. *Cf., Cantor v. Detroit Edison*, 428 U.S. at 596, concerning activity in the competitive economy. That Discon also claims it was harmed as a ratepayer

does not give credence to the argument that the competitive harm at issue was in the telephone service market, as Discon is not a provider of telephone services. Also, there would be little or no competition in the regulated monopoly telephone service market, because "public utility regulation typically assumes the private firm is a natural monopoly and that public controls are necessary to protect the consumer from exploitation." *Cantor*, 428 U.S. at 595-96. The argument that the Second Circuit saw "competitive harm" in a regulated monopoly context is a straw man as there is, by definition, no "competition" in the anti-trust sense therein, as distinguished from the suppression of competition in the unregulated supplier market.

Petitioners' arguments as to the necessity for "proof" of competitive harm are premature, because proof is not necessary on a motion to dismiss. The relevant market boundaries are normally determined by market place facts, and thus, it is the susceptibility of the market(s) alleged to proof which is considered. *See, e.g., MCM Partners*, 62 F.3d at 976-77; ABA Section of Antitrust Law, *Antitrust Law Developments* 544-45 (4th ed. 1977); ABA Section of Antitrust Law, 1997 *Annual Review of Antitrust Law Developments* at 170-71.

Petitioners' attack on the Government's theory that regulatory evasion causing anticompetitive effects was susceptible of treatment under antitrust law misapprehends the Government's theory. The Government's concern was that once the regulated monopolist became involved in conspirational efforts to harm competition in an unregulated supplier market, its conduct is subject to antitrust scrutiny. SG Petr. Br. 7-12.[18] Certainly the Court does not view as novel the susceptibility of a regulated monopoly to antitrust regulation once it becomes involved in unregulated, competitive markets. The

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18. Discon's comments about the *Copperweld* principle rejecting intracorporate enterprise conspiracy under Sherman 1 as distinguished from the *Cantor* decision's effect on susceptibility of regulated utilities to antitrust regulation when involved in competitive market activity also apply here. The actual conspirator involved is MECo., which is not regulated. Furthermore, if Petitioners are treated as the same for *Cantor* purposes, they would still be subject to antitrust regulation as the supplier market is not regulated.

Government's theory corresponds with *Cantor*, as the market from which Discon was excluded was not the telephone services market, but the removal services market. J.A. 82-92 (Am. Compl. ¶¶ 26-57).[19] To otherwise contend would cast the Government's theory as requiring antitrust regulation applied to a telephone services market which, under *Cantor*, would be considered a natural monopoly requiring regulation and being already regulated. Such an argument is counterintuitive. The conduct addressed by the Government, the Second Circuit and Discon is the conspirators' overt acts to stifle competition in the supplier market. At no time in these proceedings or the proceedings in the lower courts have Petitioners pointed to FCC or N.Y. PSC actions which provided remedies for supplier market harm, as those agencies do not have that jurisdiction. Petitioners seek to revisit the debate about the lack of explicitness and pervasiveness of federal and state communications utility regulation that do not justify "[allowing] it to stand in the way of the enforcement of the antitrust law." *AT&T Case*, 552 F. Supp. at 156-59.

E. Competitive Harm In the Removal Services Market Is Adequately Alleged.

In Point I.B.1 of this brief, Discon has set forth the content of its allegations pertaining to competitive harm in the removal services market. The basis thrust of Petitioners' argument is that the Amended Complaint deals with a regulatory and not an antitrust issue.

Petitioners' first point is that Discon's exclusion from the removal services markets effected by MECo.'s decertifying it as a vendor did not exclude Discon from serving "other available buyers of removal services[,]" and that the harm, even respecting the markets alleged, did not constitute harm to competition on a marketwide basis respecting the ability of suppliers of removal services to offer lower prices or better service in competition "with AT&T and other providers of removal services." Pet. Br. 37. There is implicit in Petitioners' position that the relevant market is not properly designated

19. The Government's theory also corresponds with Professors Areeda and Hovenkamp's observations as to when anti-trust intervention may be necessary. IIIA Areeda and Hovenkamp, *Antitrust Law* ¶ 787b.

in the Amended Complaint. Relevant market analysis is a function of market characteristics. *See, e.g., Grinnell*, 384 U.S. at 571-75. Discon's pre-discovery perception of the relevant market is set forth in Point I.B.2 *supra*, and is focused on the market in which Discon was interested in remaining and/or entering. Whether the relevant market is duly constituted in such circumstances should abide discovery. Compare, *Fishman v. Estate of Wirtz*, 807 F.2d at 531-32 (relevant market defined as that to which access had been sought and foreclosed by anti-competitive conduct even if plaintiff had other business opportunities).

Petitioners', and particularly MECo.'s, conduct in controlling the qualification of suppliers created a circumstance wherein AT&T (Technologies') would have no competition in the provision through MECo., of services to NYT (the regulated monopolist) absent MECo.'s acquiescence. This was goal of the conspiracy, to stifle competition to allow for service prices corresponding to those existing when pre-divestiture Western Electric provided removal services to NYT. J.A. 90 (Am. Compl. ¶ 51). Petitioners' argument overlooks the function of MECo., to determine "qualified" vendors in the overwhelming part of the market for such services that was not already exclusively serviced by Technologies within New York.

Petitioners' second point concerning barriers to entry, purchaser deprivation of existing alternatives, and other characteristics that would impede new firms from entering to compete to correct output shortage or raising of price simply ignores the allegations of the Amended Complaint. During the commission of overt acts to effect exclusion of Discon, MECo. ceased the practice of using extreme markups in its rebilling of vendor supplied services to NYT, instead using high cost vendors who charged above the market price. J.A. 90 (Am. Compl. ¶ 51), J.A. 86-91 (Am. Compl. ¶¶ 34, 39, 41-48, 52, 56). MECo., NYNEX and AT&T were simply not going to permit competition in the removal services market.

Petitioners' reference to other vendors (present and potential suppliers of removal services) Pet. Br. 37, refers to co-conspirators with NYNEX, MECo. and NYT to effect monopolization of the market. J.A. 111-112 (Am. Compl. ¶ 107). The Amended Complaint clearly identifies McGee as a conspirator with AT&T who was

rewarded for his work by receiving subcontracts for removals through AT&T. J.A. 85, 89 (Am. Compl. ¶¶ 33(a), 47). NYT chose not to service its removal needs, and, as alleged, did so on only 1% of the removal jobs before bidding work out itself and then through MECo. J.A. 83 (Am. Compl. ¶ 27).

Easy entry assertions by the Petitioners, Pet. Br. 37-38, ignore that Discon, as well as other vendors, had to be approved by MECo. Yet, Petitioners have not come forward to show that MECo. approved viable vendors other than Discon and Technologies.

Petitioners deem it "implausible" that "NYNEX" would be agreeing to subject itself to higher pricing set by removal service sellers in an "output-constricted (and entry protected) market." Pet. Br. 38. This is precisely what "NYNEX" did. It must not be forgotten that "NYNEX" was unitary only in terms of the intracorporate conspiracy theory disapproved in *Copperweld*. "NYNEX" was not unitary in reality, as MECo. was set up as an unregulated procurement entity that engaged in stifling of competition in the removal services market, allowing supracompetitive prices to be charged to purchaser MECo. The various parts of "NYNEX" played their roles to stifle, with AT&T, competition in the removal services market. J.A. 84-91 (Am. Compl. ¶¶ 32-57). "NYNEX" effected, through use of NYT and MECo., the very form of regulatory evasion that calls for application of the anti-trust laws, effecting the procurement functions for the regulated monopolist through a commonly controlled, but unregulated entity, through and with which it conspired with AT&T to suppress competition in the supplier market, raising the prices in that market through activity of the "separate" procurement entity.[20]

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20. Similar concerns are expressed in IIIA Areeda and Hovenkamp, Antitrust Law ¶ 787b, but such concerns are normally expressed in respect of Section 2 violations, which may explain Profession Areeda's characterization of the present case in the context of threat of monopoly, a Section 2 concern, rather than the lesser measure of market power required for a Section 1 violation. *Cf., Eastman Kodak*, 504 U.S. at 481. Why there should only be a concern with the higher monopoly standard in the context of *Cantor* is not explained by Professor Areeda.

Petitioners observe that

> [I]t is simply not rational economic behavior for a buyer like ["]NYNEX["] to agree to create market conditions — a shortage of suppliers protected by entry barriers — in which it could then be exploited.

Petr. Br. 38 (cites omitted). The allegations of the Amended complaint are specific on this point. NYT, though under the control of NYNEX and having contracted with MECo., desired to deal directly with Discon as the low cost vendor, but was repeatedly thwarted by the acts of NYNEX and AT&T, which acts are described in some detail. J.A. 84-86, 89 (Am. Compl. ¶¶ 33, 34, 35, 36 and 47). NYNEX and MECo. also are specifically alleged to have engaged in anti-competitive acts to effect exclusion of Discon. J.A. 84-92 (Am. Compl. ¶¶ 32, 34, 36-57). NYNEX's conduct in preventing NYT from dealing directly with Discon through interposition of MECo. furthered its agreement with AT&T to allow all parties to charge supracompetitive prices and generate supracompetitive profits in the supplier market. This is a version of the conduct Professors Areeda and Hovenkamp observe should be subject to antitrust regulation. IIIA Areeda and Hovenkamp, Antitrust Law ¶ 787b.

Petitioners would have this Court believe, despite FCC and N.Y. PSC investigations of NYT's transactions with its affiliates, particularly MECo., resulting in tens of millions of dollars in overcharges to NYT, that the conduct alleged of NYNEX is "implausible". MECo.'s conduct, whether it engaged in markup of Discon's bids of up to 1000% or resorted to a high-cost vendor like Technologies, was focused on inhibition of supplier market competition for NYT removals and in New York State. Discon's allegations are specific, provide evidence of overt acts and their impact. It is incredible that NYNEX so overtly attempted to suppress competition in the supplier market and then assert that the accusations about its conduct are implausible. The Amended Complaint was not properly dismissed by the District Court.

II.

A PURCHASER-SUPPLIER AGREEMENT TO EXCLUDE A COMPETING SUPPLIER CAN CONSTITUTE AN UNLAWFUL CONSPIRACY TO MONOPOLIZE WHEN THE CONSPIRATORS INTEND FOR THE CONSPIRING COMPETITOR TO MONOPOLIZE THE MARKET.

The Second Circuit concluded that the Amended Complaint stated a conspiracy-to-monopolize claim because of allegations that Petitioners conspired with AT&T to eliminate Discon with the specific intent to secure monopoly power for AT&T (*i.e.*, Technologies) in the relevant removal services markets. Pet. App. 14a-15a. The Court of Appeals correctly decided that Discon's allegations state a Section 2 claim.

In *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 612 n.1 (1977), the Court described a Section 2 conspiracy as one in which two or more actors share a specific intent to monopolize a market, that is intent to create or maintain a monopoly by improper means. In the context of a Section 2 conspiracy claim, Discon need only state allegations "of some conduct permitting an inference of specific intent to monopolize. *Strobl v. New York Mercantile Exchange*, 561 F.Supp. 379, 384 (S.D.N.Y. 1983); *see also Northeastern Tel. Co. v. American Tel. & Tel. Co.*, 651 F.2d 76, 85 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982). The Amended Complaint exceeded the standard, describing numerous events of concerted conduct involving, among others, NYNEX and AT&T, that readily infer specific intent. J.A. 86-87, 89-91, 112-113 (Am. Compl. ¶¶ 34-36, 39, 47, 51, 54, 56 and 107).[21]

Section 2 does not require that all the conspirators be competitors in the market in which monopoly power is sought. *See, e.g., Perrington Wholesale, Inc. v. Burger King Corp.*, 631 F.2d 1369, 1377 (10th Cir. 1979); *Strobl*, 561 F. Supp. at 384 (a third party not a "competitor" in the market may also serve as a Section 2 conspirator).

21. In Section 2 cases, specific intent is discerned through overt acts as well as agreements. 2 J. VonKalinowski, P. Sullivan and M. McGuirl, *Antitrust Laws and Trade Regulation* § 26.02[2] at 26-25 to -26 (2d ed. 1996).

NYNEX's objection that Discon failed to allege a relevant market is inadequate on two grounds. First, since a conspiracy to monopolize claim does not require actual or potential achievement of monopoly power, there is not a necessity of alleging a relevant market, though proof is later necessary, in a market analysis context, to show effect on a "substantial amount of commerce" and specific intent. 2 J. VonKalinowski, Sullivan and McGuirl, *Antitrust Laws and Trade Regulation* § 26.02[6]. Although Discon defines a market that the conspiracy effectively monopolized, this is not an essential element of a Section 2 conspiracy to monopolize. *Olsen v. Progressive Music Supply*, 703 F.2d 432, 438 (10th Cir.), *cert. denied*, 464 U.S. 866 (1983); *Salco Corp. v. General Motors Corp.*, 517, F.2d 567, 576 (10th Cir. 1975); *United States v. Consolidated Launderies Corp.*, 291 F.2d 563, 573 (2d Cir. 1961).[22] Second, Discon has alleged a relevant market, that for removal services within the State of New York and a narrower NYT-only market. Point I.B.2 *supra*.

Discon identified one purchaser of removal services other than the conspirators, that being Rochester Telephone. (J.A. 91 (Am. Compl. ¶ 53). If the conspiracy alleged in the Amended Complaint succeeded, excluding Discon from the removal services market with the purpose of securing monopoly power for AT&T therein, purchasers of removal services such as Rochester Telephone would have been deprived of the benefits of competition. A principal policy of Section 2 is to protect purchasers and consumers from the creation or maintenance of monopoly power. *See, e.g., American Tobacco Co.*, 328 U.S. at 788-89.

Petitioners raise two other points for the Court's consideration. First, they again argue that Discon alleged harm only to itself and not

22. "Dangerous probability" of achieving monopoly power is not required in conspiracy to monopolize cases, as distinguished from attempt cases. As stated in *Consolidated Launderies Corp.*, 291 F.2d at 573, "[W]here the charge is conspiracy to monopolize, the essential element is not the power, but specific intent to monopolize." What is required is that a "substantial amount of commerce" be affected. *DuPont*, 351 U.S. at 225. Compare, *Spectrum Sports, Inc. v. McQuillen*, 506 U.S. 447, 458-59 (1993) (in the context of Section 2, single firm conduct, inquiry required into relevant product and geographic market and economic power therein).

competition. (Pet. Br. 37-38) and because Discon argued the conspiracy was designed to obtain monopoly power for Petitioners, not AT&T (Pet. Br. 40-41). Second, it is argued Discon's claim should have been dismissed because it alleged Petitioners conspired to create a monopoly to their detriment. (Pet. Br. 38-39, 42).

Discon notes that the Court granted, and Petitioners sought, certiorari on the question whether a vertical non-price agreement between "a [p]urchaser" and its "[s]upplier" could "be characterized as a conspiracy to monopolize." Pet. i; Pet. Br. i. Petitioners' discussion of that question was couched in a buyer's freedom of choice never being subject to conspiracy to monopolize analysis, even where the result was monopoly power acquisition. Pet. 16. This proposition was also stated in terms of the purchaser's role consisting solely of favoring the purported monopolist as a supplier. Pet. 14-15. If Petitioners' arguments are addressed to the Court of Appeals' reading of the Amended Complaint as Petitioners' specifically intending to assist AT&T in monopolizing of the removal services market (Pet. Br. 39-40), this is not the issue on which certiorari was granted. The same may be said concerning the Petitioners' assertions that Petitioners' participation in a Section 2 conspiracy would be implausible in common sense terms. Pet. Br. 40-41. Petitioners seek to introduce new issues into the case that are not fairly within the scope of this Court's grant of *certiorari*. Such new issues are not fairly included in the questions presented and should not be considered, as "[o]nly questions set forth in the petition, or fairly included therein, will be considered by the Court". *Izumi Seimitsu Kogyo Kabashiki Kaisha v. U.S. Philips Corp.*, 510 U.S. at 30-32 & n.5 (1993) (application of Sup. Ct. Rule 14.1(a) as to the Court's consideration only of questions set out in the petition or fairly included therein).

The "implausibility" position has been previously addressed in this brief. Point I.D., *supra*. For the same reasons "implausibility" failed in the Section 1 context, it should also fail in the Section 2 conspiracy to monopolize contest. There are additional reasons that "implausibility" should be rejected.

"NYNEX", specifically MECo., is alleged, with ATC (AT&T) to be the dominant purchasers of removal services in the New York State area.[23] J.A. 82 (Am. Compl. ¶ 29). Technologies, Discon's competitor, was alleged to be the dominant supplier of removal services in the same market. J.A. 82-83 (Am. Compl. ¶ 26). Professors Areeda and Hovenkamp have observed that regulation changes the traditional concept of a monopolist being able to obtain "full monopoly profit" in the monopoly market, giving the monopolist no reason "to restrict output by raising the price at the [unregulated] stage into which [the monopolist] integrated."[24]

Due to regulatory avoidance that created supracompetitive prices in the supplier market, "NYNEX" behavior, as reflected by MECo. activity, was contrary to that of a buyer in an unregulated supplier market who would be expected to procure at the lowest cost. "NYNEX", *i.e.* MECo. and NYT, would be expected to reduce transaction costs in the purchase of services in the unregulated supplier market. This did not happen, indicating that the purchaser dominance presented a monopsony problem, which, as in the monopoly context, injuries consumers. It is rational, not implausible, that NYNEX would participate in a conspiracy to monopolize the supplier market as this would complement the purchasing dominance of NYNEX and AT&T. This would damage consumers in the removal services market, such as Rochester Telephone, while permitting the pass-through of supracompetitive prices to the regulated monopoly customers.[25] "NYNEX" may be both a monopolist in NYT's

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23. This is not an acknowledgment that a Section 2 conspiracy to monopolize claim requires relevant market allegations.

24. IIIA Areeda and Hovenkamp, Antitrust Law ¶¶ 787b at 282.

25. "NYNEX"'s conduct is the converse of what a regulated monopolist would be expected to do in its supplier market. In *Kartell v. Blue Shield (Mass.)*, 749 F.2d 922, 930-931 (1st Cir. 1984), *cert. den.*, 471 U.S. 1029 (1985), Blue Cross capped prices it would pay for physician services, by refusing to allow participating physicians services, by refusing to allow participating physicians from charging more than Blue Cross paid the physicians. Ultimately, this resulted in consumer benefit to the extent that supracompetitive prices were undermined or lower service prices resulted in lower premiums. *See also* IIA P. Areeda, H. Hovenkamp and J. Solow, (Cont'd)

regulated telephone service market and a monopsonist in the supply market for removal services.

With the dominance of AT&T and NYNEX in the removal service purchaser market, there is the prospect, if not the existence, of cartelizing in the purchase of removal services which, like cartels among sellers, can disrupt the market. *See* IIA Areeda, Hovenkamp and Solow, *Antitrust Law*, ¶ 574 at 301 & n.7. That the cartelizing purchasers sought to induce supracompetitive prices in the supplier market by conspiracy with Technologies to monopolize that market is not surprising when the disruption of the supplier market, with its supracompetitive prices, could work to the purchasers' benefit. This is simply another version of the conduct of regulated monopolists who integrate into an unregulated market and distort the unregulated supply market by seeking to monopolize that market by elimination of competition therein. Compare, *Olympia Equip. Leasing Co. v. Western Union Tel. Co.*, 797 F.2d 370, 374 (7th Cir. 1986) (Posner, J.), *cert. den.*, 480 U.S. 987 (1984).

Discon posed a threat to the conspiracy to monopolize the removal services market by its very existence as a low cost competitor to Technologies. As the Second Circuit observed, the Amended Complaint sufficiently alleged Petitioners conspired with Technologies and performed overt acts intending to assist Technologies in monopolizing the removal services market. Specific intent plead was met by allegations that MECo. sought Technologies' dominance to ensure suppression of competing suppliers who would bypass MECo. and deal directly with NYT. Pet. App. 14a-15a. This directly contravenes Petitioners' assertion that the "profit-making mechanism of regulatory evasion in no way depended on or implied" the creation of monopoly power in the removal services market. Pet. Br. 38. The citation by Petitioners of *TV Communications Network, Inc. v. Turner Network Television. Inc.*, 964 F.2d 1022, 1026-27 (10th Cir.), *cert. denied*, 506 U.S. 999 (1992) is of no aid to their position, because

(Cont'd)
Antitrust Law ¶ 574 at 299-300. (1995 rev. ed.). It also has been pointed out that most Section 1 challenges usually fail because the insurer is a single buyer and can unilaterally shop for favorable terms. P. Areeda and L. Kaplow, *Antitrust Analysis* 251, n.27 (1988)

the complainant in that case failed to allege "a relevant market which TNT was capable of monopolizing, attempting to or conspiring to monopolize." *Id.* at 1028. The complaint had alleged the relevant product market as "the market for the TNT channel in Metropolitan Denver", in response to which the Tenth Circuit stated that "a company does not violate the Sherman Act by virtue of the natural monopoly it holds over its own product." *Id.* at 1025, citing *DuPont*, 351 U.S. at 393. The "implausibility" alluded to by Petitioners is, *inter alia*, a natural monopoly over one's own product does not violate Sherman 2, an "implausibility" at law. NYNEX has not, in the present case, previously referred to the market for removal services as one in which Technologies had a "natural monopoly" that made a Sherman 2 claim legally unsustainable.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

LAWRENCE C. BROWN
Counsel of Record
JOHN H. RING, III
Attorneys for Respondent
360 Dingens Street
Buffalo, New York 14206
(716) 826-3038

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In the Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION, ET AL., PETITIONERS

v.

DISCON, INCORPORATED

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL TRADE COMMISSION AS AMICI CURIAE IN SUPPORT OF VACATING THE JUDGMENT

SETH P. WAXMAN
Solicitor General
Counsel of Record

JOEL I. KLEIN
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

A. DOUGLAS MELAMED
Deputy Assistant Attorney General

BARBARA MCDOWELL
Assistant to the Solicitor General

CATHERINE G. O'SULLIVAN
MARK S. POPOFSKY
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

DEBRA A. VALENTINE
General Counsel
Federal Trade Commission
Washington, D.C. 20580

35 pp

QUESTIONS PRESENTED

1. Whether an agreement between a purchaser and a supplier to eliminate a competing supplier may be condemned as an unlawful group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. 1.

2. Whether a purchaser may conspire to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. 2, when the purchaser agrees with a supplier to eliminate a competing supplier with the specific intent to assist the first supplier in its acquisition or maintenance of monopoly power.

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INTEREST OF THE UNITED STATES AND THE FEDERAL TRADE COMMISSION

The United States and the Federal Trade Commission have primary responsibility for enforcing the federal antitrust laws and thus have a substantial interest in ensuring that the Sherman Act is construed in a manner that advances, rather than impedes, its objectives. At this Court's invitation, the United States and the Federal Trade Commission filed a brief at the petition stage of this case.

STATEMENT

1. Respondent Discon, Incorporated (Discon), supplied "removal services," consisting of the salvage and disposal of obsolete telephone central office equipment, in the State of New York. Amend. Compl. ¶ 13 (J.A. 78). A principal user of removal services in the State was petitioner New York Telephone Company (NYT), a regulated subsidiary of petitioner NYNEX and the monopoly provider of local telephone exchange service throughout most of the State. *Id.* ¶¶ 2, 23, 29 (J.A. 76, 81, 83). Other users of removal services in the State included Rochester Telephone Company and AT&T, through its affiliate AT&T Communications. *Id.* ¶¶ 2, 23, 29, 53 (J.A. 76, 81, 83, 91). AT&T purchased removal services exclusively from its affiliate AT&T Technologies, the leading supplier of removal services in the State and a competitor of Discon in supplying removal services to NYT. *Id.* ¶¶ 26, 29 (J.A. 82-83). During the period at issue, NYT ordinarily purchased removal services through petitioner NYNEX Materiel Enterprises (MECo), a NYNEX subsidiary that served as a purchasing agent for NYNEX and its affiliates. *Id.* ¶¶ 24-27 (J.A. 82-83). Although the rates that NYT charged to local telephone users were regulated, the prices that MECo charged to NYT were not. *Id.* ¶¶ 27, 30 (J.A. 83-84).

According to Discon's complaint, from 1984 through at least 1986, petitioners and AT&T took advantage of that regulatory structure to implement a conspiracy designed to overcharge NYT's customers for local telephone service.[1] MECo purchased

[1] Because the court of appeals correctly treated NYNEX and its wholly owned subsidiaries, NYT and MECo, as a single antitrust entity in the circumstances presented by this case (see Pet. App. 8a-10a), we ascribe MECo's alleged conduct to NYNEX and NYT.

removal services from AT&T, allegedly at inflated prices. MECo allegedly passed these prices on to NYT, which submitted them to state regulators as a cost of providing local telephone service. Because the regulators set NYT's rates for local telephone services based on its cost of service, NYT recovered from its local telephone customers the amounts that it paid to MECo (and hence AT&T) for removal services. AT&T allegedly then paid MECo a secret year-end rebate that, in effect, reduced the prices that MECo paid for AT&T removal services below the levels that NYT disclosed to state regulators. Amend. Compl. ¶¶ 30-31, 59, 64-67, 110 (J.A. 83-84, 92-94, 112-113). Thus, as the court of appeals explained, petitioners allegedly "were able to generate increased revenues that were essentially derived from [NYT's] telephone monopoly" while avoiding "oversight from the state regulatory commission." Pet. App. 5a.

Because the conspiracy, as alleged in Discon's complaint, hinged on MECo's acceptance of inflated bids from AT&T and on the state regulators' assumption that the prices that NYT disclosed to them were legitimate, the conspiracy was at risk of being exposed if the regulators learned of lower bids submitted by competing lower-cost suppliers, particularly absent any satisfactory explanation as to why those suppliers had not been selected over AT&T. Discon alleged that it posed precisely such a threat because it refused to join the conspiracy, sought to sell removal services directly to NYT instead of

acting through MECo, and underbid AT&T's inflated bids. Amend. Compl. ¶¶ 40-45, 52 (J.A. 87-88, 90).[2]

According to Discon's complaint, in order to eliminate the threat posed by Discon, petitioners and AT&T conspired to exclude Discon from the market. Amend. Compl. ¶¶ 2-3, 32-33 (J.A. 75-77, 84-86). Petitioners, among other things, granted contracts to AT&T even when Discon, a lower-cost supplier, submitted substantially lower bids. *Id.* ¶ 34 (J.A. 86). Petitioners also decertified Discon as an approved supplier for NYNEX affiliates and, in concert with AT&T, disseminated false information designed to provide state regulators with facially legitimate (but wholly pretextual) reasons for Discon's decertification. *Id.* ¶¶ 33, 47, 50, 53-56 (J.A. 84-86, 89-91). Barred from supplying the major users of removal services in New York, Discon went out of business. *Id.* ¶¶ 108, 113 (J.A. 112-113). The result, according to the complaint, was that AT&T "perpetuated its monopoly

[2] According to Discon's complaint, the scheme ultimately was uncovered and, in 1992, state regulators "prohibited most transactions between NYT and unregulated affiliates." Amend. Compl. ¶ 16 (J.A. 79). The FCC also initiated enforcement proceedings against NYT for apparent violation of FCC rules in connection with "unreasonable markups and overcharges by MECO on sales of equipment, supplies, and services to NYT," which, "in turn, recorded these artificially inflated costs on [its] regulated books of account, enabling [it] to recover these costs from ratepayers through the ratemaking process." *In re New York Tel. Co.*, 5 FCC Rcd 866 (1990). NYT subsequently entered into a consent decree; without admitting liability, NYT agreed to refund more than $35 million for "unreasonable rates reflecting improper capital costs and expense charges." *In re New York Telephone Co.*, 5 FCC Rcd 5892, 5893 (1990) (internal quotation marks omitted).

over the supply of removal services to NYT." *Id.* ¶ 26 (J.A. 83).

2. Discon brought suit against petitioners in May 1990 and, following dismissal of its original complaint, filed an amended complaint alleging, among other things, that the above-described conduct violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. 1, 2. Discon's complaint characterized MECo as a separate antitrust entity that competed with AT&T and Discon in supplying removal services to NYT. Amend. Compl. ¶¶ 2, 29 (J.A. 75-76, 83). Accordingly, in responding to petitioners' motion to dismiss for failure to state a claim, Discon principally argued that petitioners and AT&T had entered into an unlawful horizontal agreement designed to secure monopoly power in the removal services markets. In the alternative, Discon maintained that petitioners and AT&T had entered into a vertical price-fixing scheme that was per se unlawful under Section 1. Discon only briefly asserted that the alleged scheme also violated Section 1 under a rule-of-reason theory by "eliminat[ing] competition in the market for the provision of removal services."[3] Petitioners essentially ignored Discon's rule-of-reason theory in seeking dismissal of the complaint.[4]

The district court granted petitioners' motion to dismiss the complaint. The court refused to characterize the alleged conspiracy as horizontal, concluding that MECo could not properly be viewed as a supplier of removal services. Pet. App. 28a-29a. The court held that any other Section 1 theory failed

[3] Opposition to Motion to Dismiss 20 (Mar. 1, 1993).

[4] See Reply Memorandum in Support of Motion to Dismiss 4-10 (Mar. 22, 1993).

because Discon had not adequately alleged a conspiracy. *Id.* at 30a-31a. The court also dismissed Discon's claims under Section 2 for monopolization and attempted monopolization, concluding that petitioners neither competed nor sought to obtain monopoly power in the removal services market. *Id.* at 32a-36a. The court rejected Discon's Section 2 conspiracy-to-monopolize claim both for that reason and for failure adequately to allege a conspiracy. *Id.* at 37a-38a.

3. The court of appeals affirmed in part, reversed in part, and remanded for further proceedings. Pet. App. 1a-15a, 20a. With respect to the Section 1 claim, the court of appeals agreed with the district court that MECo could not properly be characterized as a supplier of removal services and, therefore, that "Discon cannot succeed on its theory of a classic horizontal restraint of trade," the theory on which Discon had "primarily" relied. *Id.* at 8a, 10a. The court nonetheless reinstated Discon's Section 1 claim on the ground that "Discon may be able to prevail under a different legal theory." *Id.* at 10a; see also *id.* at 7a ("the complaint states a cause of action under Section One of the Sherman Act, though under a different legal theory than the one articulated by Discon").

Invoking *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the court concluded that an agreement between vertically situated actors, including one between a single supplier and a single purchaser, could be characterized as an unlawful "group boycott" if the agreement had "a horizontal market impact." Pet. App. 11a. The court recognized that "*in general* two-firm vertical combinations will be scrutinized as exclusive distributorship controversies, rather than as group boycotts." *Id.* at 12a (citing *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717 (1988)). The court purported to distinguish a "per se" unlawful "group boycott" from a vertical restraint analyzed under the rule of reason based on whether the restraint "has no purpose except stifling competition." *Id.* at 13a (internal quotation marks omitted).

Because Discon alleged that "the intent and effect of [petitioners'] choosing AT&T Technologies over Discon was entirely anti-competitive," the court of appeals concluded that Discon "alleged a cause of action under, at least, the rule of reason." Pet. App. 12a-13a. The court did not, however, identify any particular market affected by the alleged conspiracy between AT&T and petitioners to exclude Discon. Nor did the court identify any particular anticompetitive effect of that alleged conspiracy.[5] The court also concluded that Discon might have stated a claim under "the *per se* rule applied to group boycotts in *Klor's*" if Discon substantiated its allegations that the restraint "ha[d] no purpose except stifling

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[5] The court of appeals noted (Pet. App. 12a) that "overcharg[ing] captive rate-paying customers" was an object of the conspiracy. But the court did not, as petitioners now assert (Pet. Br. 17), clearly identify such overcharges as the *anticompetitive* effect stemming from Discon's elimination. The court's failure to focus on that issue is hardly surprising in light of the scant attention that the parties devoted to it in their briefs. Compare Discon C.A. Br. 20 (conclusorily asserting that the conspiracy "violated the rule of reason" because it "harmed competition in the central office removal market in New York with no offsetting benefit" and because it "was intended to and led to [petitioners' and AT&T's] sharing of monopolistic prices") with Appellee C.A. Br. 19-20 (arguing that the decision to use one supplier instead of another cannot violate the Sherman Act).

competition." *Id.* at 13a (internal quotation marks omitted).[6]

With respect to the Section 2 claims, the court of appeals, while affirming the dismissal of the monopolization and attempted monopolization claims, reinstated the conspiracy-to-monopolize claim. Pet. App. 14a. The court reasoned that "[a] defendant may be liable for conspiracy to monopolize where it agrees with another firm to assist that firm in its attempt to monopolize the relevant market." *Ibid.* The court determined that Discon had "sufficiently allege[d]" that petitioners "conspired with AT&T Technologies and performed overt acts" with the specific "inten[t] to assist AT&T Technologies in its monopolization of the market for removal services." *Id.* at 15a.

SUMMARY OF ARGUMENT

The court of appeals concluded that an agreement between a firm and its supplier to exclude a competing supplier is a "group boycott," and "per se" unlawful under Section 1 of the Sherman Act, if the agreement is found, after a case-specific inquiry, to produce solely anticompetitive effects. Under this Court's decisions, however, only certain concerted refusals to deal by competitors warrant a categorical and conclusive presumption of predominantly anticompetitive effects and thus may be invalidated as group boycotts. See *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 294 (1985).

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[6] Reversing the district court, the court of appeals also held that the complaint adequately alleged a vertical conspiracy between petitioners and AT&T. Pet. App. 7a n.3. The court, however, agreed with the district court that the complaint failed to allege a per se unlawful vertical resale price maintenance agreement. *Id.* at 10a n.5.

The conspiracy alleged here does not fall into any of the categories that this Court has previously denominated as per se illegal and, because vertical agreements to deal with one supplier often serve procompetitive purposes even if they disadvantage a rival supplier, per se treatment is inappropriate regardless of the label affixed to the arrangement. See *State Oil Co.* v. *Khan*, 118 S. Ct. 275, 279 (1997).

The court of appeals correctly concluded, however, that two firms may conspire to monopolize a market, in violation of Section 2 of the Sherman Act, even if only one of the firms competes in that market, as long as both specifically intend that one firm obtain monopoly power and agree to engage in conduct that is directed to that end and that lacks any legitimate business justification. Petitioners' contention that the Section 2 claim should have been dismissed because of asserted pleading deficiencies in the complaint is not properly before this Court. And petitioners' argument that the claim should have been dismissed because it is "implausible" that petitioners specifically intended to assist AT&T in obtaining monopoly power is incorrect. Regulation—and, in particular, schemes designed to avoid it—may create an incentive for a monopolist to engage in anticompetitive conduct that it would not engage in absent regulation. The court of appeals found in the complaint allegations that petitioners had an incentive to help AT&T obtain monopoly power because competing suppliers of removal services jeopardized petitioners' scheme to evade regulation. It is not "inherently implausible" in such circumstances for the benefits to petitioners from regulatory evasion to outweigh the costs, if any, to petitioners if AT&T obtained monopoly power.

We believe that the appropriate disposition of this case is to vacate the judgment of the court of appeals and to remand the case for further proceedings on both the rule-of-reason claim under Section 1 and the conspiracy-to-monopolize claim under Section 2. The court of appeals determined that the complaint alleged a Section 1 claim under the rule of reason but did not elaborate on the nature of that claim, which the court recognized (Pet. App. 7a) to be based on "a different legal theory than the one articulated by Discon." Although petitioners raise in this Court a number of objections to the court of appeals' rule-of-reason holding, those contentions neither were raised below nor are fairly included within the question presented. Because the court of appeals did not have an opportunity to consider those objections and misapprehended the law relating to group boycotts, we believe that the court should be directed to give further consideration to whether the complaint states a claim under the rule of reason. The court of appeals also reinstated the Section 2 claim based on a theory that Discon had not clearly pressed below. Because the court did not have an opportunity to consider petitioners' current objections to that theory, and because the court was not entirely clear as to whether Discon adequately alleged that petitioners conspired with the specific intent to secure monopoly power for AT&T, the court should also be directed to give further consideration to whether Discon adequately alleged a conspiracy to monopolize.

ARGUMENT

I. THE COURT OF APPEALS ERRONEOUSLY CONCLUDED THAT A VERTICAL AGREEMENT TO EXCLUDE A COMPETING SUPPLIER MAY BE A PER SE UNLAWFUL GROUP BOYCOTT

The court of appeals erred in concluding (Pet. App. 12a-13a) that the alleged conspiracy to "discriminate in favor of [AT&T] over [Discon]" could be invalidated as a per se unlawful group boycott.

1. "Although the Sherman Act, by its terms, prohibits every agreement 'in restraint of trade,' this Court has long recognized that Congress intended to outlaw only unreasonable restraints." *State Oil Co.* v. *Khan*, 118 S. Ct. 275, 279 (1997). "Some types of restraints, however, have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful *per se*." *Ibid.* Application of the per se rule to such restraints serves the salutary purposes of "provid[ing] guidance to the business community" and "minimiz[ing] the burdens on litigants and the judicial system of the more complex rule-of-reason trials." *Continental T. V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 50 n.16 (1977).

This Court has long held that certain concerted refusals to deal are "so likely to restrict competition without any offsetting efficiency gains that they should be condemned as *per* se violations of § 1 of the Sherman Act." *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 290 (1985). And the Court has repeatedly listed "[g]roup boycotts" among the classes of concerted

refusals to deal that "merit *per se* invalidation." *Id.* at 293 (citing cases). Conduct that is properly classified as a "group boycott" is thus "conclusively presumed to be anticompetitive." *Id.* at 290, 294-295; *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458 (1986) (conduct properly denominated a "boycott" is subject to "the *per se* rule"). See also, *e.g.*, *Arizona* v. *Maricopa County Med. Soc'y*, 457 U.S. 332, 344 n.15 (1982) ("group boycotts" are "[a]mong the practices which the courts have heretofore deemed to be unlawful in and of themselves") (quoting *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958)); *United States* v. *General Motors Corp.*, 384 U.S. 127, 145-146 (1966) ("[g]roup boycotts" are "among those classes of restraints which from their nature or character [are] unduly restrictive" and thus "are conclusively presumed to be unreasonable") (internal quotation marks omitted); *Summit Health, Ltd.* v. *Pinhas*, 500 U.S. 322, 337 (1991) (Scalia, J., dissenting) ("group boycotts are *per se* violations").

Because those restraints that are denominated "group boycott[s]" violate the Sherman Act "without regard to the reasonableness of the conduct in the circumstances," *General Motors*, 384 U.S. at 145-146, this Court has mandated that "[s]ome care" be exercised in "defining the [types] of concerted refusals to deal" that "fall within the forbidden category." *Northwest Wholesale Stationers*, 472 U.S. at 294; *Indiana Fed'n of Dentists*, 476 U.S. at 458 ("the category of restraints classed as group boycotts is not to be expanded indiscriminately"). The category does not encompass "every cooperative activity involving a restraint or exclusion." *Northwest Wholesale Stationers*, 472 U.S. at 295. It is restricted to "form[s] of concerted activity" that are "characteristically likely

to result in predominately anticompetitive effects." *Ibid.*; accord *Indiana Fed'n of Dentists*, 476 U.S. at 458. Indeed, the Court has applied the "group boycott" label only to agreements among competitors that restricted their freedom to deal with third parties. See, *e.g.*, *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 734 & n.5 (1988) ("group boycotts" are "agreements among competitors to refuse to deal" and "involve[] horizontal combinations") (quoting Robert Bork, *The Antitrust Paradox* 330 (1978)); *Indiana Fed'n of Dentists*, 476 U.S. at 458 (per se unlawful group boycott category "has generally been limited to cases in which firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor"); *Northwest Wholesale Stationers*, 472 U.S. at 294 (citing cases); cf. *FTC* v. *Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 434 (1990) (describing "boycotts" as "horizontal arrangement[s] among competitors").[7]

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[7] Petitioners suggest (Pet. Br. 14-17 & n.14) that the Court used the terms "group boycott" and "concerted refusal to deal" interchangeably in *Northwest Wholesale Stationers* and, therefore, that group boycotts may be evaluated under "either a *per se* or a rule-of-reason standard" (*id.* at 16, 19 & n.16). As noted in the text, however, the Court made clear in *Northwest Wholesale Stationers* that only certain concerted refusals to deal merit per se treatment and that only those restraints properly are denominated as "group boycotts." See 472 U.S. at 294-295. Thus, as petitioners acknowledge (Pet. Br. 17 n.14), although the district court in that case held that the arrangement at issue, "[e]ven if it is a group boycott," was subject to rule-of-reason analysis, this Court was more precise in its terminology, approving the district court's recognition that "not all *concerted refusals to deal* should be accorded *per se*

Confining the "group boycott" category to conspiracies that include some horizontal element—*i.e.*, involving "[r]estraints imposed by agreement between competitors," *Business Elecs.*, 485 U.S. at 730—reflects the justification for the per se/rule-of-reason distinction. In contrast to certain horizontal restraints, vertical nonprice restraints are often procompetitive and, therefore, are presumptively evaluated under the rule of reason. See, *e.g.*, *id.* at 724-726; *GTE Sylvania*, 433 U.S. at 58-59; cf. *State Oil*, 118 S. Ct. at 281 (discussing such restraints). Although such arrangements can cause anticompetitive effects in certain circumstances, categorical condemnation is generally unwarranted.[8] Thus, in *Business Electronics*, this Court refused to characterize an agreement between a manufacturer and a dealer to terminate a price-cutting dealer as a per se unlawful group boycott. See 485 U.S. at 726-727, 734. Although the dissent argued that the "boycott" label was appropriate because the particular facts of the case showed the agreement to be unrelated to any procompetitive purpose, see *id.* at 744-748 (Stevens, J., dissenting), the Court refused to apply the per se rule because the *type* of restraint at issue had not been shown to be one that "almost always tends to restrict competition and reduce output." *Id.* at 726-727.

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treatment." *Northwest Wholesale Stationers*, 472 U.S. at 297 & n.9 (internal quotation marks omitted; emphasis added).

[8] The exception consists of certain tying arrangements, which are subject to per se invalidation only if the seller of the tying product enjoys market power. See *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, 504 U.S. 451, 461-462 (1992); *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 12-15 (1984).

2. Under this Court's decisions, the restraint at issue here—a vertical agreement between a purchaser and a supplier to exclude another supplier—cannot properly be termed a "group boycott." As the court of appeals acknowledged (Pet. App. 12a), "[i]n the vast majority of cases, the decision to discriminate in favor of one supplier over another will have a pro-competitive intent and effect." That correct observation precludes categorical condemnation of such arrangements. Indeed, virtually any requirements contract could be characterized as a "two-firm vertical" agreement "to discriminate in favor of one supplier over another." *Ibid.* Yet, such agreements are considered generally to enhance efficiency and thus are subject to evaluation under the rule of reason. See *Tampa Elec. Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 334 (1961); *Standard Oil Co.* v. *United States*, 337 U.S. 293, 306-307 (1949); *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring); *U.S. Healthcare, Inc.* v. *Healthsource, Inc.*, 986 F.2d 589, 595 (1st Cir. 1993) (Boudin, J.); *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 236-237 (1st Cir. 1983) (Breyer, J.) (citing cases from other circuits).

The court of appeals reached a contrary conclusion in this case because it used the terms "group boycott" and "per se" in a manner that finds no support in this Court's decisions. The court appeared to use "group boycott" not to refer to a class of restraint that warrants categorical condemnation because of its inherently anticompetitive character, but rather to denote a vertical agreement to exclude a supplier when, on the facts of a particular case, the agreement is found to have solely anticompetitive effects. And the court denominated the outcome of that case-specific exami-

nation "*per se* invalidation" even though the court required the sort of detailed inquiry into anticompetitive effects and procompetitive justifications that the per se rule is designed to avoid. See, *e.g.*, *Northwest Wholesale Stationers*, 472 U.S. at 289; *Maricopa County Medical Soc'y*, 457 U.S. at 343-344; *GTE Sylvania*, 433 U.S. at 50 & n.16. In *Business Electronics*, however, this Court declined the dissent's suggestion that an agreement between a producer and a dealer could be deemed a "group boycott" and per se invalid if, based on an examination of "the precise character of the agreement" at issue, that agreement was found to be "simply [a] naked restraint[] on price competition" with no procompetitive justification. See 485 U.S. at 726-730; *id.* at 742-748 (Stevens, J., dissenting).

This Court's decision in *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), which the court of appeals relied on to derive its understanding of "the *per se* rule applied to group boycotts" (Pet. App. 13a), does not support the decision here. *Klor's* turned not on a case-specific assessment of anticompetitive effects and procompetitive justifications, but rather on a categorical evaluation of the defendants' conduct. See 359 U.S. at 212-213; see also *General Motors*, 384 U.S. at 145-146 (observing that the "group boycott" in *Klor's* was held to violate the antitrust laws "without regard to the reasonableness of the conduct in the circumstances"); *Radiant Burners, Inc.* v. *Peoples Gas Light & Coke Co.*, 364 U.S. 656, 659 (1961) (per curiam). Indeed, the *Klor's* Court expressly rejected the notion that the defendants' conduct did not implicate the Sherman Act "because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy."

359 U.S. at 213. Moreover, although the court of appeals described the agreements among the defendants in *Klor's* as "essentially vertical in nature" (Pet. App. 11a), the *Klor's* Court emphasized that the case involved not a "manufacturer and a dealer agreeing to an exclusive distributorship" but rather "a wide combination consisting of manufacturers, distributors and a retailer," 359 U.S. at 212-213. This Court has since described the case as standing for the principle that "any agreement by a group of competitors to boycott a particular buyer or group of buyers is illegal *per se*." *FMC* v. *Aktiebolaget Svenska Amerika Linien*, 390 U.S. 238, 250 (1968); accord *General Motors*, 384 U.S. at 146. And in *Business Electronics*, the Court made clear that *Klor's* rule of per se illegality was tied to the existence there of a "horizontal combination[]." 485 U.S. at 734.

Accordingly, the court of appeals erred in concluding that the vertical agreement between petitioners and AT&T, if shown to "ha[ve] no purpose except stifling competition" in the particular circumstances of this case (Pet. App. 13a (internal quotation marks omitted)), could be invalidated as a per se unlawful "group boycott." Discon's allegations of a Section 1 violation should be judged solely under the rule of reason.

3. Because the question presented with respect to Section 1 is limited to whether the court of appeals erred in characterizing the agreement that Discon alleged as an illegal "group boycott" (Pet. i; Pet. Br. i),[9] there is no occasion for this Court to address

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[9] Similarly, in the portion of the petition addressing the Section 1 claim, petitioners focused on urging the Court to review the Second Circuit's "[e]xten[sion] of the [g]roup [b]oycott [r]ule

petitioners' arguments (Pet. Br. 22-39) that Discon failed to state a claim not only under the per se rule but also under the rule of reason. The rule-of-reason question is analytically distinct from, and not "fairly included" within, the question presented. *Izumi Seimitsu Kogyo Kabushiki Kaisha* v. *U.S. Philips Corp.*, 510 U.S. 27, 30-32 & n.5 (1993) (per curiam) (explaining that "'[o]nly the questions set forth in the petition, or fairly included therein, will be considered by the Court'" and that the mere "fact that the parties devoted a portion of their merits briefs" to an issue "does not bring that question properly before" the Court) (quoting Sup. Ct. R. 14.1(a)); accord *Pennsylvania Dep't of Corrections* v. *Yeskey*, No. 97-634 (June 15, 1998), slip op. 6; *Cass County* v. *Leech Lake Band of Chippewa Indians*, No. 97-174 (June 8, 1998), slip op. 11 n.5. A question, such as the rule-of-reason question here, that "is merely complementary or related to the question presented in the petition for certiorari is not fairly included therein." *Izumi Seimitsu*, 510 U.S. at 31-32 (internal quotation marks omitted).

Moreover, petitioners' arguments not only are beyond the questions presented, but also turn on issues

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of *Klor's*" (Pet. 7), a decision which, as noted in the text, involved a per se unlawful group boycott. See also, *e.g.*, *id.* at 9 (criticizing the court of appeals' "reach[ing] out to apply *Klor's*"); *id.* at 10 (arguing that "the holding of the court below that the group boycott doctrine of *Klor's* can be extended to two-firm supplier-purchaser situations has created a sharp conflict among circuits"); *id.* at 12 (criticizing the court of appeals' "extension of the group boycott rule of *Klor's* to vertical non-price agreements"); *id.* at 13 (urging review of court of appeals' holding on Section 1 "insofar as it creates a new rule of two-firm supplier-purchaser group boycott").

that were neither raised nor specifically addressed below. Those include the admittedly "novel" (Pet. Br. 36) question whether a supplier such as Discon can prevail on a rule-of-reason claim that is based on a regulatory evasion scheme.[10] As the United States previously noted (U.S. Pet. Br. 18-20), the Court would be required to address petitioners' rule-of-reason claim without the benefit of either a developed factual record or any analysis of the pertinent issues by the lower courts. Such circumstances counsel for "faithful application" of Rule 14.1(a). *Izumi Seimitsu*, 510 U.S. at 34; cf. *Walker Process Equip., Inc.* v. *Food Mach. & Chem. Corp.*, 382 U.S. 172, 178 (1965) (concluding that "even though the *per se* claim fails at this stage of litigation," the case "should be remanded for [the plaintiff] to clarify the asserted violations * * * and to offer proof thereon," in part because of "the novelty of the claim asserted and the paucity of guidelines available in the decided cases").

4. We believe that the court of appeals' judgment reinstating the Section 1 claim should be vacated and

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[10] As petitioners recognize (Pet. Br. 20-22), there is no need to address that question in order to conclude that the scheme that Discon alleged is not unlawful per se. Whether or not a scheme to exclude a supplier for the purpose and with the effect of facilitating the evasion of regulation violates the antitrust laws in some circumstances (cf. U.S. Pet. Br. 7-12), the courts obviously lack sufficient experience with such "novel" (Pet. Br. 36) claims to warrant the creation of a new category of per se illegality. See *State Oil*, 118 S. Ct. at 279 ("*Per se* treatment is appropriate '[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it.'") (quoting *Maricopa County Med. Soc'y*, 457 U.S. at 344).

remanded for further consideration by the court of appeals.[11] The court of appeals stated that the complaint was sufficient to "allege[] a cause of action under * * * the rule of reason" (Pet. App. 13a), but it did not specify the nature of the claim, which the court recognized (Pet. App. 7a) to be based on "a different legal theory than the one articulated by Discon" on appeal. The court did not identify the market that allegedly was affected or explain the nature of the anticompetitive effects that allegedly occurred. Nor did the parties' arguments before that court focus on those issues. For those reasons, and because the sufficiency of the complaint to state a claim under the rule of reason is not fairly included within the questions presented, we believe that a remand is appropriate to allow the court of appeals to address the objections to a rule-of-reason claim that petitioners now raise. See *State Oil*, 118 S. Ct. at 285 (remanding the Section 1 claim for further consideration under the rule of reason following the Court's rejection of a per se theory and despite the court of appeals' prior conclusion that "if the rule of reason is applicable, [the plaintiff] loses") (internal quotation marks omitted).[12]

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[11] Although petitioners now urge otherwise (Pet. Br. 15, 39, 43), they suggested that very disposition in seeking certiorari. See Pet. Supp. Br. 2.

[12] If the complaint sufficiently alleges a conspiracy to monopolize under Section 2, that conspiracy would also constitute an unreasonable agreement in restraint of trade under Section 1, and thus provide a basis for sustaining the judgment with respect to Section 1. See, *e.g.*, 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 809, at 370 (1996). However, for the same reasons the Court should vacate and remand the judgment with respect to the Section 2 claim, see

II. AN AGREEMENT BETWEEN A PURCHASER AND A SUPPLIER TO EXCLUDE A COMPETING SUPPLIER CAN CONSTITUTE AN UNLAWFUL CONSPIRACY TO MONOPOLIZE WHEN THE PARTIES SPECIFICALLY INTEND THE CONSPIRING SUPPLIER TO MONOPOLIZE THE MARKET

The petition presents the second question (Pet. i; Pet. Br. i) whether a vertical agreement between a supplier and a purchaser that does not involve price restraints may be characterized as a conspiracy to monopolize under Section 2 of the Sherman Act. The court of appeals implicitly answered that question in the affirmative. It concluded (Pet. App. 14a-15a) that Discon's complaint stated a conspiracy-to-monopolize claim because it alleged that petitioners conspired with AT&T to eliminate Discon with the specific intent to secure monopoly power for AT&T in the relevant removal services markets. The court of appeals' conclusion that such allegations state a claim under Section 2 is correct.

1. Section 2 proscribes "combin[ations] or conspir[acies] * * * to monopolize any part of the trade or commerce." 15 U.S.C. 2. The gravamen of such an offense is a conspiracy entered into by two or more actors sharing the specific intent to monopolize a market, *i.e.*, an intent to create or maintain monopoly power through improper means. See *United States Steel Corp.* v. *Fortner Enters., Inc.*, 429 U.S. 610, 612 n.1 (1977); see also *e.g.*, *Northeastern Tel. Co.* v.

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pp. 28-29, *infra*, the Court should leave for the court of appeals to determine on remand whether the Section 1 claim should proceed on the ground that the complaint adequately alleges a conspiracy to monopolize.

American Tel. & Tel. Co., 651 F.2d 76, 85 (2d Cir. 1981), cert. denied, 455 U.S. 943 (1982). The court of appeals read the complaint to allege those elements here: that petitioners conspired with AT&T to eliminate Discon from the removal services market, with the specific intent to secure monopoly power for AT&T in that market, by engaging in a course of conduct that lacked any efficiency justification. See Pet. App. 12a, 14a-15a.

To be sure, petitioners were not sellers in the alleged removal services markets and, therefore, did not seek to acquire monopoly power for themselves in those markets. But neither the text of the Sherman Act nor the procompetitive policy that it embodies suggests that a conspiracy designed to secure monopoly power for one of two conspirators is beyond the scope of Section 2 merely because the other conspirator does not compete in the market in which monopoly power is sought. See *Perington Wholesale, Inc.* v. *Burger King Corp.*, 631 F.2d 1369, 1377 (10th Cir. 1979) (concluding that "traders oriented vertically to each other can be found in violation of section 2 by conspiring to monopolize one horizontal market intersecting the vertical arrangement"). Section 2 proscribes conspiracies designed to achieve a particular result that is harmful to consumers: the creation or maintenance of monopoly power. See *American Tobacco Co.* v. *United States*, 328 U.S. 781, 788-789 (1946). Such competitive harm would befall consumers, "whose interests the statute was especially intended to serve," *Jefferson Parish*, 466 U.S. at 15, regardless of whether such power is shared by both of the conspirators or enjoyed by only one of them.

AT&T's acquisition of monopoly power over removal services plausibly would inflict such consumer

injury here. Discon's complaint alleges that the State of New York is a relevant removal services market and identifies at least one purchaser of removal services in that market other than the conspirators, Rochester Telephone Company. Amend. Compl. ¶ 53 (J.A. 91). If, as the Second Circuit appeared to read the complaint, the conspiracy to exclude Discon was designed to secure monopoly power for AT&T in that market, the success of the conspiracy would have eliminated competition in the market that benefited other purchasers of removal services, such as Rochester Telephone.[13]

2. Petitioners do not appear to dispute this analysis. See Pet. Br. 37, 42. They nonetheless contend that this Court should order the dismissal of the Section 2 claim on either of two other grounds: *first*, that the court of appeals misread Discon's complaint in finding that it sufficiently alleged a conspiracy to assist AT&T to monopolize the market for removal services (Pet. App. 15a), because Discon alleged harm only to itself and not to competition generally in the removal services market (Pet. Br. 37-38) and because Discon alleged, and argued below, that the consipiracy was designed to obtain monopoly power not for AT&T but for petitioners (*id.* at 40-41); and, *second*, that the court of appeals should have applied a heightened pleading standard because any claim that petitioners conspired to impose a monopoly on themselves is "implausible" (*id.* at 38-39, 42).

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[13] There is accordingly no need to consider whether the complaint would allege a Section 2 violation if the removal services market were limited to the narrower, NYT-only market that Discon also averred.

Those issues are not properly before this Court. Petitioners sought, and this Court granted, certiorari on the question whether a vertical non-price agreement between "a [p]urchaser" and its "[s]upplier" could "be characterized as a conspiracy to monopolize." Pet i; Pet. Br. i. In the portion of the petition discussing that question, petitioners simply argued, in general terms, that "a buyer's choice of one supplier rather than another" should never be viewed as a conspiracy to monopolize, even "where the result is the acquisition of monopoly power." Pet. 16.[14] Petitioners did not seek review of the court of appeals' reading of the complaint as alleging that petitioners specifically intended to assist AT&T in monopolizing the removal services market. Petitioners likewise did not seek review of the pleading standard applied by the court of appeals to Discon's conspiracy-to-monopolize claim.

Because the question presented is limited to whether a vertical agreement between a purchaser and supplier *ever* can be characterized as a conspiracy to monopolize, petitioners' various objections to the court of appeals' reading of the complaint are not "fairly included," Sup. Ct. Rule 14.1(a), within the question presented. Nor does the question presented

[14] See also Pet. 14-15 (challenging the court of appeals' "assum[ption]" that a "theory of conspiracy to monopolize is applicable where a purchaser agrees to buy from one supplier (the alleged would-be monopolist) rather than another, and where the purchaser's role in the alleged conspiracy to monopolize consists solely of favoring the alleged would-be monopolist as a supplier of the purchaser's needs"); Pet. Reply Br. 3 ("[R]espondent cites no case which has held that a buyer's choice of one supplier over another may be a conspiracy to monopolize.").

fairly encompass petitioners' contention, raised for the first time in their merits brief, that a heightened pleading standard should apply because allegations that NYNEX intended to confer monopoly power on AT&T are implausible. Petitioners should not be permitted to interject into the case new issues, many of them factbound, that are not fairly within the scope of the questions on which this Court granted certiorari. See *Izumi Seimitsu*, 510 U.S. at 30-34 (explaining that "faithful application of Rule 14.1(a)" furthers the Court's policy of "strongly 'disapprov[ing] the practice of smuggling additional questions into a case after we grant certiorari'") (quoting *Irvine* v. *California*, 347 U.S. 128, 129 (1954) (per curiam)).

3. It is arguable that the question presented does fairly include petitioners' contention that dismissal is warranted on the ground that "the theory that NYNEX conspired with the specific intent to subject itself, as buyer, to the monopoly power of AT&T is intrinsically implausible." Pet. Br. 42; see also *id.* at 38; Pet. Supp. Br. 10. Petitioners' "implausibility" argument, while principally offered in support of the heightened pleading standard discussed above, may also be read as suggesting that courts should reject, as a matter of law, *any* claim that a purchaser conspired with its supplier with the specific intent to facilitate the supplier's acquisition of monopoly power, *i.e.*, that such conduct cannot properly "be characterized as a conspiracy to monopolize." Pet. i; Pet. Br. ii. Even if a claim could properly be dismissed when otherwise sufficient allegations are "implausible," however, dismissal is not warranted here.

As petitioners point out (Pet. Br. 38-39), "the rational monopolist will usually want his input markets to be competitive, for competition usually will mini-

mize the costs that he has to pay for his inputs." *Olympia Equip. Leasing Co.* v. *Western Union Tel. Co.*, 797 F.2d 370, 374 (7th Cir. 1986) (Posner, J.), cert. denied, 480 U.S. 934 (1987); see also *Car Carriers, Inc.* v. *Ford Motor Co.*, 745 F.2d 1101 (7th Cir. 1984), cert. denied, 470 U.S. 1054 (1985). "There are, however, special circumstances in which a rational monopolist may want to restrict competition in an input market; as it happens, one of those circumstances is where the monopolist's rates are regulated." *Olympia*, 797 F.2d at 374. For instance, a monopolist subject to rate regulation "may have an incentive to project its monopoly into related but unregulated markets" in order, for example, to "smuggle" some of its profits in the regulated market, which "regulators would otherwise force it to pass on to the ratepayers," into the rates that it charges in the unregulated market. *Ibid*; see generally 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 787, at 282-285 (1996).

A regulated monopolist likewise might vertically integrate into an input market, sell the input to itself at a supracompetitive price, and recover the entire price from captive ratepayers. If other firms in the market are selling the input at a lower price, however, regulators may discover that the monopolist's vertical integration, rather than serving exclusively procompetitive ends, is designed to evade rate regulation and obtain monopoly rents. Thus, the monopolist might have an incentive to eliminate other suppliers—indeed, to acquire a second monopoly in the input market—in order to suppress the threat to its regulatory evasion posed by competing suppliers. Cf. *Olympia*, 797 F.2d at 374.

Similarly, under the allegations of Discon's complaint as construed by the court of appeals (see Pet. App. 14a-15a), it is not "inherently implausible" (Pet. Br. 39) that petitioners had an incentive to eliminate competition among suppliers of removal services. The alleged agreement between petitioners and AT&T to inflate the price of removal services and to share the resulting profits between themselves would have served as a substitute for the sort of "straightforward monopolistic" price increase that regulation prevented.[15] And such a scheme could have been jeopardized if regulators became aware of the competing bids of Discon and any other suppliers of removal services. The eliminiation of such competitors, as well as the assertion of wholly pretextual reasons for refusing to deal with them, could thus serve to conceal the scheme.

In arguing that "[t]he alleged profit-making mechanism of regulatory evasion in no way depended on or implied" the creation of monopoly power in the removal services market (Pet. Br. 38), petitioners overlook the nature of the threat that competing suppliers, such as Discon, allegedly posed to the regulatory evasion scheme. It it both plausible and consistent with the complaint, as the court of appeals read it, for petitioners to have concluded that the scheme could be concealed from regulators only by the elimination of competing suppliers. The immediate gains to petitioners from the profitable regulatory evasion scheme could, at least conceivably, have outweighed the risk of future loss from AT&T's acquisition of monopoly power. The regulatory structure allowed petitioners to pass on to ratepayers any monopoly price that AT&T charged for removal services. Accordingly, if

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[15] Thomas G. Krattenmaker, *Telecommunications Law and Policy* 516 (1994).

the demand for local telephone service remained relatively inelastic, petitioners' loss, if any, from AT&T's acquisition of monopoly power could be small,[16] and could be more than offset by the gain from the regulatory evasion scheme.

Allegations that petitioners specifically intended to assist AT&T in monopolizing the removal services market thus are not so "preposterous" as to warrant dismissal as a matter of law. Pet. Br. 39 (quoting *Car Carriers*, 745 F.2d at 1110). To be sure, summary judgment may ultimately be warranted if the evidence uncovered does not support a reasonable inference that petitioners acted with the specific intent to monopolize. See *Matsushita Elec. Indus. Co* v. *Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); cf. *Hospital Bldg. Co.* v. *Trustees of Rex Hosp.*, 425 U.S. 738, 747 n.5 (1976). But there is no basis for dismissing the complaint, as the court of appeals read it, on the ground that "it is simply not rational economic behavior for a buyer like NYNEX to agree to create market conditions * * * in which it could then be exploited." Pet. Br. 38.

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[16] The parties might have structured the division of profits from the regulatory evasion scheme to compensate petitioners for any loss resulting from AT&T's anticipated acquisition of monopoly power. Cf. Amend. Compl. ¶¶ 31, 59, 110 (J.A. 84, 92, 112-113) (allegations of rebates from AT&T to petitioners). Evidence of such an arrangement, of course, is likely to be "in the hands of the alleged conspirators," a circumstance that has informed this Court's teaching that in antitrust cases "dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly." *Hospital Bldg. Co.* v. *Trustees of Rex Hosp.*, 425 U.S. 738, 746 (1976) (internal quotation marks omitted).

4. Although the court of appeals correctly held that petitioners, under certain circumstances, could be held liable for conspiring to monopolize the removal services market, we nonetheless believe that the Court should vacate the court of appeals' judgment and remand the Section 2 claim (along with the Section 1 claim, see pp. 19-20, *supra*) for further proceedings. The petition (see Pet. 14) and our discussion here are premised on the understanding that the court of appeals read the complaint to allege that petitioners engaged in a conspiracy with the specific intent to assist AT&T in acquiring monopoly power in the relevant removal services market through improper means. The court's opinion, however, is not completely clear on the point. See, *e.g.*, Pet. App. 15a (finding sufficient allegations that petitioners sought AT&T's "dominance," but not explaining whether "dominance" encompasses monopoly power). And, absent a specific intent to confer monopoly power on AT&T through improper means, a Section 2 claim would not be stated. In these circumstances, we believe that it would be appropriate to remand the case to allow the court of appeals to clarify the basis for its decision and to determine whether the Section 2 claim should proceed.

This disposition is particularly appropriate in light of the court of appeals' reinstatement of the Section 2 claim based on a theory that Discon did not clearly advance. As noted above, petitioners' merits brief in this Court raises a number of objections to the court of appeals' reinstatement of the Section 2 claim that are not fairly included within the question presented in the petition. Because the court of appeals found that the Section 2 claim was sufficiently alleged on a basis "not previously argued," *Trest* v. *Cain*, 118 S.

Ct. 478, 481 (1997), petitioners have not yet had a chance fully to present these arguments to the court of appeals. They should be given that opportunity on remand.

CONCLUSION

The judgment of the court of appeals should be vacated, and the cause remanded for further proceedings.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
JOEL I. KLEIN
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
A. DOUGLAS MELAMED
Deputy Assistant Attorney General
BARBARA MCDOWELL
Assistant to the Solicitor General
CATHERINE G. O'SULLIVAN
MARK S. POPOFSKY
Attorneys

DEBRA A. VALENTINE
General Counsel
Federal Trade Commission

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION; NYNEX MATERIEL ENTERPRISES COMPANY; NEW YORK TELEPHONE COMPANY,

Petitioners,

—v.—

DISCON, INCORPORATED,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF AMICUS CURIAE IN SUPPORT OF THE PETITIONERS

RICHARD M. STEUER
425 Park Avenue, 12th Floor
New York, New York 10022
(212) 836-8483

Attorney for Amicus Curiae
The Association of the Bar
of the City of New York

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Pursuant to Rule 37 of the Rules of this Court, this brief is respectfully submitted, in support of the Petitioners, by *amicus curiae,* the Association of the Bar of the City of New York. The consent of the parties to the filing of this brief has been requested. Petitioners have given consent; respondent has not.

INTEREST OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

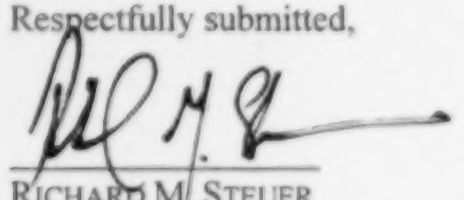
The Association of the Bar of the City of New York (the "Association") is an organization composed of over 21,000 attorneys. While most members of the Association practice in the New York tri-state area, there are members from almost every state and from over 50 foreign countries. The Committee on Antitrust and Trade Regulation, which has participated in studying and shaping antitrust law and trade regulation policy for several decades, is comprised of lawyers with a wide range of perspectives. Members of the Committee include practitioners who represent both plaintiffs and defendants, as well as academicians.

The Second Circuit's August 26, 1996 decision in this matter was brought to the attention of the Association by one of the parties. The Association is concerned that this decision could cause serious confusion with respect to the distinction between horizontal and vertical restraints of trade under Section 1 of the Sherman Act, 15 U.S.C. § 1.

Accordingly, the Association respectfully moves for leave to file the "Brief Amicus Curiae of the Association of the Bar of the City of New York in Support of the Petitioners" which is submitted herewith. The filing of this brief has been

approved by the President of the Association in accordance with Section XIII of the Association's by-laws.

Respectfully submitted,



RICHARD M. STEUER
425 Park Avenue, 12th Fl.
New York, New York 10022
(212) 836-8483

Chair, Committee on Antitrust
and Trade Regulation

Attorney for Amicus Curiae
The Association of the Bar of
the City of New York

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

No. 96-1570

NYNEX CORPORATION;
NYNEX MATERIEL ENTERPRISES COMPANY;
NEW YORK TELEPHONE COMPANY,

Petitioners,

— v. —

DISCON, INCORPORATED,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF AMICUS CURIAE OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK IN SUPPORT OF THE PETITIONERS

Pursuant to Rule 37 of the Rules of this Court, this brief is respectfully submitted, in support of the Petitioners, by *amicus curiae*, the Association of the Bar of the City of New York. The consent of the parties to the filing of this brief has been requested. Petitioners have given consent; respondent has not.

INTEREST OF *AMICUS CURIAE*

The Association of the Bar of the City of New York (the "Association") is an organization composed of over 21,000 attorneys. While most members of the Association practice in the New York tri-state area, there are members from almost every state and from over 50 foreign countries. The Committee on Antitrust and Trade Regulation, which has participated in studying and shaping antitrust law and trade regulation policy for several decades, is comprised of lawyers with a wide range of perspectives. Members of the Committee include practitioners who represent both plaintiffs and defendants, as well as academicians. The Committee, the Association and their members have a substantial interest in the Court's determination as to when a vertical agreement may be treated as a horizontal restraint under the Sherman Act.[1]

SUMMARY OF ARGUMENT

Unless the decision of the Court of Appeals for the Second Circuit with respect to the application of Section 1 of the Sherman Act is reversed, it will have the effect of allowing every supplier that is displaced by an agreement between a customer and a new supplier to seek treble damages based on a violation of the federal antitrust laws. Such suits would target claims of *per se* antitrust liability against lost customers, where the former supplier otherwise would be limited to filing state law claims based on tortious interference against the new

---

[1] This brief was not authored in whole or in part by counsel for a party. No person or entity, other than the *amicus curiae*, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

supplier. Because the *per se* rule presumes illegality, the defendants in these cases would be precluded from presenting evidence of justifications.

Of particular concern is the fact that the Second Circuit based its decision on court of appeals cases that were decided prior to this Court's decision in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988). Although the Second Circuit acknowledged the relevance of *Sharp*, it failed to recognize the fact that *Sharp* actually overruled the earlier authority under which a defendant's decision to substitute a new supplier or distributor for an old one could be treated as a horizontal restraint. For these reasons we urge this Court to reverse the decision below and take this opportunity to clarify the law regarding horizontal effects arising from vertical relationships. In particular, we urge this Court to adopt the approach developed over the years by the courts of appeals, applying the rule of reason to cases involving the substitution of a new supplier or distributor for an old one within a vertical relationship.

ARGUMENT

The Association respectfully submits the following comments in support of the Petitioners.

The Court Should Reject Application of the Per Se Rule to "Two-Firm Group Boycotts." Without expressing an opinion on either the appropriate resolution of the motion to dismiss that is the subject of the present appeal, or the ultimate outcome of this litigation, the Association urges the Court to reverse the decision of the Court of Appeals for the Second Circuit, which applied Section 1 of the Sherman Act, 15 U.S.C. § 1, to what that court termed "two-firm group boycotts." 93 F.3d 1055, 1061. The Association's concern is that the Second Circuit's broad formulation as to when a vertical agreement may be treated as a horizontal restraint, crafted *sua sponte* without the benefit of briefing or argument by the parties, and without a full explanation of how it fits within applicable Supreme Court precedent, will have a powerful influence beyond this particular case.

The Second Circuit's decision with respect to the application of Section 1 of the Sherman Act turns on the proposition that an agreement between two firms in a vertical relationship may be characterized as a horizontal restraint if it seeks to disadvantage a competitor of one of the parties to the agreement and has no purpose except stifling competition. Specifically, the Second Circuit observed that "an agreement between two firms . . . even in a vertical relationship, may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor . . . of one of the conspiring firms," and the court added that such a restraint might fall within "the *per se* rule applied to group boycotts

. . . if the restraint of trade 'has no purpose except stifling competition.'"[2]

The concern raised by this formulation is that it could be interpreted to reach virtually every agreement between a customer and a supplier that displaces another supplier. By a parity of reasoning it also could be interpreted to reach agreements between a supplier and a customer that displace another customer, including a customer that is a distributor. This would invite a flood of federal antitrust litigation seeking treble damages on behalf of jilted suppliers and distributors. These suits would assert claims of *per se* antitrust liability in situations where, at most, the disappointed supplier or distributor otherwise would be limited to pursuing a state law claim against the replacement for tortious interference with business relationships and/or unfair competition. Because the *per se* rule presumes illegality, defendants in these suits would be precluded from presenting evidence of justifications.

What makes the Second Circuit's ruling particularly significant is the fact that it is based on *Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126 (2d. Cir. 1978), and other cases that were decided before this Court's decision in *Sharp Electronics Corp.*, 485 U.S. at 725-31 & n.4. Although the Second Circuit's opinion acknowledged the relevance of *Sharp*, it did not recognize that *Sharp* actually overruled earlier authority under which a defendant's decision to substitute a new supplier or distributor could be treated as a horizontal restraint. This Court explained in *Sharp* that "a restraint is

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[2] 93 F.3d at 1061, *citing Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126, 131 (2d Cir. 1978) (en banc), *quoting White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement" (*i.e.*, an agreement "between competitors"). 485 U.S. at 730 n.4. Further, the majority in *Sharp* explicitly admonished that applying the horizontal label to vertical agreements "introduces needless confusion into antitrust terminology." *Id.* at 730.

The opinion below should be reexamined precisely because it introduces needless confusion by treating a vertical restraint as horizontal on the ground that it has horizontal effects.

The Court Should Take This Occasion to Clarify the Rule Applicable to the Substitution of Suppliers and Distributors. This case presents an appropriate opportunity for this Court to clarify the law applicable to the substitution of a new supplier or distributor for an old one. Although an ample body of law has developed in the lower courts on this subject, this Court has had few occasions to express a view of its own.

Specifically, in *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919), this Court held that "in the absence of any purpose to create or maintain a monopoly," it is not a Sherman Act violation for a trader "to exercise his own independent business discretion as to parties with whom he will deal." It took almost seventy years for the Court to add, in *Sharp*, *supra*, that it is neither a horizontal agreement nor *per se* unlawful for a manufacturer to substitute a new distributor for an old one at the behest of the new one. 485 U.S. at 725-31 & n.4.

In between, the law on substitution of suppliers and distributors evolved largely through a series of lower court

rulings. Most prominent was the D.C. Circuit's decision in the *Packard* case. There, the court held that the creation of an exclusive dealership by terminating one distributor at the behest of another was not unlawful, and pointed out that the rule that had evolved in earlier cases was "virtually one of *per se* legality." *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418, 420 (D.C. Cir. 1957) (*quoting* Milton Handler, *Annual Antitrust Review*, 11 RECORD OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK 367, 370 (1956)).

Subsequently, a series of lower court decisions confirmed that the substitution of one exclusive distributor for another normally does not diminish competition and is generally lawful. These decisions culminated in two cases that have been cited with great regularity, *Ace Beer Distributors, Inc. v. Kohn, Inc.*, 318 F.2d 283 (6th Cir. 1963), and *Burdett Sound, Inc. v. Altec Corp.*, 515 F.2d 1245 (5th Cir. 1975). In *Ace Beer* the court emphasized that "the substitution of one distributor for another in a competitive market . . . does not eliminate or materially diminish . . . existing competition . . . , is not an unusual business procedure, and, in our opinion, is not an unreasonable restraint of trade." 318 F.2d at 287. In *Burdett*, the court admonished:

> Lest any other former distributors succumb to the temptation of treble damages, we reiterate that it is simply not an antitrust violation for a manufacturer to contract with a new distributor, and as a consequence, to terminate his relationship with a former distributor, even if the effect of the new contract is to seriously damage the former distributor's business.

515 F.2d at 1249. Other circuits have held to the same effect.[3]

The message of these cases is that claims based on the substitution of one dealer or supplier for another should be dismissed unless there is a plausible claim of harm to overall competition in the relevant market, not just to one competitor, building on this Court's repeated instruction that the antitrust laws as a whole are intended to protect competition, not competitors. *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458-59 (1993).[4]

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[3] *Crane & Shovel Sales Corp. v. Bucyrus-Erie Co.*, 854 F.2d 802, 806 (6th Cir. 1988) ("We have consistently held that a complaint which simply alleges that a manufacturer substituted one distributor for another fails to state a violation of the rule of reason, *unless* it also alleges anticompetitive effect at the interbrand level"); *Rutman Wine Co. v. E. & J. Gallo Winery*, 829 F.2d 729, 735 (9th Cir. 1987); *Dunn & Mavis, Inc. v. Nu-Car Driveaway, Inc.*, 691 F.2d 241, 243-44 (6th Cir. 1982); *White v. Hearst Corp.*, 669 F.2d 14, 19 (1st Cir. 1982); *DeVoto v. Pacific Fidelity Life Ins. Co.*, 618 F.2d 1340, 1344 (9th Cir.1980); *Northwest Power Products Inc. v. Omark Industries*, 576 F.2d 83, 91 (5th Cir. 1978); *Knutson v. Daily Review, Inc.*, 548 F.2d 795, 803 (9th Cir. 1976).

[4] The complaint alleges that NYNEX and AT&T Technologies sought not merely to prevent Discon from competing for NYNEX's business but to prevent it from competing in the removal services market at all, *see* J.A. 76; *see also* J.A. 84, and it has been argued that if this could be proved, it should result in *per se* illegality regardless of whether the agreement was horizontal or vertical. If this were all that is necessary to plead a case of *per se* illegality, however, it

(continued...)

The gap that exists between the formulation in these cases and the formulation of the Second Circuit in the present case is illuminated by examining the very recent decision in *Electronics Communications Corp. v. Toshiba America Consumer Products, Inc.*, 129 F.3d 240 (2d Cir. 1997), decided after the present case by a different panel of the Second Circuit. There, the court cited the *Burdett* case and agreed that "without a showing of an actual adverse effect on competition market-wide, for a manufacturer to terminate a distributor . . . and to appoint an exclusive distributor" is not a violation of the antitrust laws. Then, as if to highlight the anomalous nature of the *Discon* decision, that panel observed that the *Discon* panel had distinguished the *Discon* case from a case involving "a typical exclusive distributorship arrangement because the conduct alleged [in *Discon*] was manifestly anticompetitive and no procompetitive rationale appeared on the face of the complaint." 129 F.3d at 244-245. This explanation of *Discon* is not sufficiently instructive, however. It suggests a reason why the conduct alleged in *Discon* might not receive as favorable treatment under the rule of reason as the creation of a "typical" exclusive distributorship, but still does not explain

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[4] (...continued)
would subsume the rule of reason in every substitution case in which the terminated supplier or distributor alleges that it cannot replace the business it stands to lose. Indeed, the plaintiff in *Packard* quit the market entirely as a result of its imminent termination. *Packard Motor Car Co.*, 243 F.2d at 419; *see also Ace Beer Distributors, Inc.*, 318 F.2d at 285-86 (allegation that sole supplier's termination substantially destroyed plaintiff distributor); *Burdett Sound, Inc.*, 515 F.2d at 1249 (termination alleged to have seriously damaged plaintiff distributor).

how or why that conduct ever should be subject to a rule of *per se* illegality.

Accordingly, if this Court rejects the Second Circuit's "two-firm group boycott" formulation, it should then consider clarifying what rule is, in fact, properly applicable to the substitution of a new supplier or distributor for an old one.

In *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 764 (1984), this Court embraced a formulation on conspiracy found in the Third Circuit's opinion in *Edward J. Sweeney & Sons, Inc. v. Texaco Inc.*, 637 F.2d 105, 111 n.2 (3d Cir. 1980). In the present case, the Court similarly may choose to adopt the formulation on the substitution of suppliers or distributors found in the D.C. Circuit's opinion in *Packard*, the Sixth Circuit's opinion in *Ace Beer* and the Fifth Circuit's opinion in *Burdett*. This would provide the lower courts greater assurance that in applying the rule of reason to vertical substitution cases in the future, they would be applying that rule in a manner consistent with the interpretations of this Court. It also would provide members of the bar greater guidance for distinguishing between meritorious substitution cases and those that are destined to fail.[5]

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[5] This Court may also take this opportunity to address the Second Circuit's holding that a conspiracy to monopolize claims against a customer under Section 2 of the Sherman Act, 15 U.S.C. § 2, can be based on a vertical agreement between the customer and a new supplier which displaces a previous supplier.

CONCLUSION

Wherefore, the Association respectfully submits that the decision of the Court of Appeals should be reversed.

Respectfully submitted,

RICHARD M. STEUER
425 Park Avenue, 12th Fl.
New York, New York 10022
(212) 836-8483

Chair, Committee on Antitrust
and Trade Regulation
Attorney for Amicus Curiae
The Association of the Bar
of the City of New York

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No. 96-1570

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES COMPANY,
AND NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF FOR THE BUSINESS ROUNDTABLE AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

Of Counsel
ROBERT C. WEINBAUM
3031 West Grand Boulevard
Detroit, Michigan 48202

THOMAS B. LEARY *
WILLIAM L. MONTS, III
LYNDA K. MARSHALL
HOGAN & HARTSON L.L.P.
Columbia Square
555 Thirteenth Street, N.W.
Washington, D.C. 20004-1109
(202) 637-5600

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

No. 96-1570

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES COMPANY,
AND NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The Business Roundtable respectfully moves for leave to file the attached brief amicus curiae in this case. The consent of both parties has been requested. Counsel for petitioners has consented in writing; counsel for respondent has consented orally but written confirmation has not been received.

The companies represented in the Roundtable are engaged in a wide variety of businesses and are subject to a wide variety of government regulations, including the antitrust laws. They do not condone violations of government regulations by fellow members or by others, but they also believe it is harmful to apply regulatory remedies and penalties in areas where they do not belong. Specifically, the Roundtable members believe it is harmful to apply the

antitrust laws to claims of fraudulent conduct which—however reprehensible—does not involve harm to the competitive process.

It is evident from petitioners' brief, which asked this Court to review the decision below, that the lower court failed to appreciate the distinction between standards of proof applied to horizontal agreements and those applied to vertical agreements. The former may be subject to *per se* condemnation; the latter are normally judged under the rule of reason. The distinction is critical in this case because the plaintiff-respondent has not pleaded competitive harm.

Petitioners will understandably emphasize this infirmity in the decision below because this Court has spoken so clearly on the subject and because the Department of Justice and the Federal Trade Commission apparently agree that this aspect of the decision is wrong.* The members of The Business Roundtable are concerned about this horizontal/vertical issue, but are even more concerned about a different aspect of the opinion.

The decision below permits plaintiff-respondent to make an antitrust case out of what is nothing more than a claim of regulatory fraud—namely, a scheme by which a cost-plus regulated utility artificially inflated its costs. Even if the conduct caused harm to consumers, however, it is not harm that flows from injury to the competitive process. It is harm appropriately addressed in a different proceeding.

If the lower court's decision is upheld, it could have consequences that extend well beyond the world of cost-plus utility regulation. There are a wide variety of regulatory offenses that could be transmuted into antitrust cases under the theories adopted below and apparently endorsed by the Department of Justice and the Federal Trade Commission.

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* Brief for the United States and the Federal Trade Commission as Amicus Curiae On Petition For a Writ of Certiorari at 14.

Because The Business Roundtable has a diverse membership, and because none of its members are directly involved in the case before the Court (Petitioner NYNEX Corporation was a member of The Business Roundtable until August 1997), it can provide a different perspective on this issue of whether the antitrust laws are misapplied. For this reason, The Business Roundtable requests that the following brief in support of petitioners be accepted for filing.

Respectfully submitted,

Of Counsel
ROBERT C. WEINBAUM
3031 West Grand Boulevard
Detroit, Michigan 48202

THOMAS B. LEARY *
WILLIAM L. MONTS, III
LYNDA K. MARSHALL
HOGAN & HARTSON L.L.P.
Columbia Square
555 Thirteenth Street, N.W.
Washington, D.C. 20004-1109
(202) 637-5600

* Counsel of Record

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DISCON INCORPORATED,
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On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR THE BUSINESS ROUNDTABLE AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF AMICUS CURIAE

The Business Roundtable is an association of about 200 chief executive officers of leading U.S. corporations, employing over 10 million people.[1] These members examine policy issues that affect the economy and develop positions which they believe will promote the general welfare through application of sound economic and social principles.

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[1] Pursuant to Rule 37.6 of the Rules of the Supreme Court, *amicus* states that no counsel for a party has authored any part of this brief, and no person or entity, other than the *amicus*, its members or its counsel, made any monetary contribution to the preparation or submission of this brief.

The companies represented in the Roundtable are engaged in a wide variety of businesses and are subject to a wide variety of government laws and regulations, including the antitrust laws. They do not condone violations of the law by fellow members or by others, but they also believe it is harmful to apply legal remedies and penalties in areas where they do not belong. Specifically, the Roundtable members believe it is harmful to apply the antitrust laws to claims of fraudulent conduct which—however reprehensible—does not involve harm to the competitive process.

This amicus brief will therefore emphasize a point that has not been emphasized in the briefs previously filed; namely, that this case involves a claim of regulatory fraud disguised as an antitrust case.

SUMMARY OF ARGUMENT

The petitioners and the amici that argued in favor of review by this Court have shown that the court below failed to appreciate the distinction between standards of proof applied to horizontal agreements and those applied to vertical agreements. The lower court did not apply the rule in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988), which held that non-price vertical agreements must be analyzed under the rule of reason, not a rule of *per se* illegality.

The threshold question under the rule of reason is whether there is a plausible claim of harm to competition (as opposed to harm to an individual competitor). The lower court did not require plaintiff-respondent to plead competitive harm, but instead seemed to require that the defendant-petitioner affirmatively justify a decision to change suppliers. The court thus sustained what is nominally an antitrust claim, but which is really a claim of regulatory fraud that could be addressed in another appropriate forum.

Antitrust remedies should not be used to supplant other regulatory schemes. There are many activities that harm competitors, or even consumers, which do not implicate the antitrust laws because they do not harm the competitive process. Misapplication of the antitrust remedies imposes unwarranted burdens on economic activity and leads to distortion and confusion in the development of substantive antitrust law.

ARGUMENT

I. THE LOWER COURT'S FAILURE TO APPLY *SHARP* HAS TRANSMUTED A FRAUD CLAIM INTO AN ANTITRUST CASE.

The lower court's opinion has blurred the fundamental distinction between horizontal and vertical agreements, contrary to the clear direction of this Court in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988). It failed to apply *Sharp*'s unambiguous holding that the rule of reason, not the *per se* rule, is properly applied to non-price vertical restraints. The lower court said:

> We do not decide at this point whether the District Court on remand should apply a *per se* rule . . . .[2]

The distinction is critical here, as in many other cases, because respondent has not pleaded facts that show injury to competition, and therefore has no viable case under the rule of reason. *See Electronics Communications Corp. v. Toshiba Am. Consumer Prods, Inc.*, 129 F.3d 240, 244 (2d Cir. 1997) (termination of a distributor is not "a violation of the antitrust laws, without a showing of an actual adverse effect on competition market-wide . . .").

It is well-established that under the rule of reason, the plaintiff bears the burden of proving that a restraint has

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[2] Pet. App. 13a n.6.

a substantial anticompetitive effect,[3] and that absent such an effect the defendant need not offer or prove justifications for its conduct.[4] Thus, the lower court initially made not one, but three fundamental errors in this case: it failed to rule out application of the *per se* rule to a type of conduct that this Court has held should not be viewed as *per se* illegal; it failed to require the respondent to meet its threshold burden under the rule of reason of pleading facts that show a substantial anticompetitive effect from the challenged conduct; and it assumed that the absence of a procompetitive motive for the challenged conduct could by itself cure the deficiency in respondent's proof.

Sharp declined to apply the *per se* rule to an agreement between a manufacturer and a dealer to terminate another discounting dealer and reaffirmed the fundamental principle that the *per se* rule is reserved for agreements that are so inherently anticompetitive that they "would always or almost always tend to restrict competition and decrease output." *Sharp*, 485 U.S. at 723 (citation omitted). The Court observed that its:

> approach to the question presented in the present case is guided by the premises of *GTE Sylvania* and *Monsanto*: that there is a presumption in favor of a rule-of-reason standard; that departure from that standard must be justified by *demonstrable economic effect, such as the facilitation of cartelizing, rather*

[3] *Standard Oil Co. v. United States*, 283 U.S. 163, 179 (1931); *see generally* AMERICAN BAR ASS'N, ANTITRUST LAW DEVELOPMENTS (FOURTH) 55 n.287 (1997) (cases cited therein).

[4] *See* ANTITRUST LAW DEVELOPMENTS (FOURTH), *supra* note 3, at 55 n.288; *see also, e.g., Capital Imaging Assocs. v. Mohawk Valley Med. Assocs.*, 996 F.2d 537, 547 (2d Cir.), *cert. denied*, 510 U.S. 947 (1993); *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 596 (1st Cir. 1993); *Schachar v. American Academy of Ophthalmology, Inc.*, 870 F.2d 397, 400 (7th Cir. 1989); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 229 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033 (1987).

> *than formalistic distinctions*; that interbrand competition is the primary concern of the antitrust laws; and that rules in this area should be formulated with a view towards protecting the doctrine of *GTE Sylvania*.

Id. at 726 (emphasis added).

Because the lower court failed to apply the clear message of the *Sharp* case, it allowed respondent to transmute a fraud claim into an antitrust case.

This point emerges clearly when the case is stripped down to its essentials. NYNEX and its wholly-owned subsidiaries New York Telephone Company, a regulated provider of telephone services, and NYNEX Materiel Enterprises, an agent which purchased services for the telephone company, are accused of a conspiracy to avoid rate regulation. Under this scheme, the regulated seller of telephone services was able to inflate its cost basis artifically because one of its suppliers agreed to falsify the real transaction prices on invoices and later pay a secret rebate. It is asserted that the offending defendants discontinued respondent Discon as a supplier because it would not go along with the scheme.

The mere substitution of one competitor for another in the supply of services to the telephone company is not a matter of competitive concern, standing alone. The lower court recognized that: "[i]n the vast majority of cases, the decision to discriminate in favor of one supplier over another will have a pro-competitive intent and effect." Pet. App. 12a (*citing Sharp*, 485 U.S. at 724-25). The opinion goes on to say, however, that "no such procompetitive rationale appears on the face of the complaint," and accordingly holds that the complaint states a cause of action. *Id.* at 12a-13a. The court apparently misreads *Sharp* to suggest that a defendant customer bears some affirmative burden of showing that there

is a pro-competitive reason for its decision to deal with one supplier rather than another.[5]

This is simply wrong. Under the antitrust laws, a customer is normally free to deal with whomever it pleases, for good reasons or for bad. *Cf. United States v. Colgate & Co.*, 250 U.S. 300 (1919). It is only when a rejected supplier can show some harm to competition in a relevant market (not just harm to itself) that an antitrust inquiry may appropriately consider the reasons for the supplier selection. And improper objectives will not support an antitrust claim unless they involve an attempt to suppress competition—for example, by fixing resale prices. *See Sharp*, 485 U.S. at 735. It is not enough simply to show an intent to violate some other legal or moral imperative. This Court observed in one of its more recent antitrust decisions: "It is axiomatic that the antitrust laws were passed for 'the protection of *competition*, not *competitors*.'" *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (*quoting Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)) (emphasis in original). The Court pointed out that:

> Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or "purport to afford remedies for all torts committed by or against persons engaged in interstate commerce."

Id. at 225 (citation omitted).

[5] The lower court's mistaken allocation of burden was undoubtedly influenced by its failure to appreciate the significance of the distinction between horizontal and vertical arrangements, which was clearly articulated by this Court in *Sharp*. The opinion cites a number of pre-*Sharp* cases for the proposition that a purchase agreement between a customer and a single supplier can be characterized as a "group boycott" of the excluded supplier. Pet. App. 10a-12a. This fundamental mistake has, however, been adequately highlighted in the briefs of petitioners and others, and there is no need to repeat the arguments here.

If antitrust law prohibited supplier selections prompted by corruption, as claimed by the lower court, it could with equal logic prohibit supplier selections prompted by misrepresentation,[6] by commercial bribery,[7] by unlawful prejudice, or by supplier willingness to give customer's convenience a higher priority than compliance with burdensome safety or environmental regulations. Antitrust law could swallow every other area of government regulation. This unwarranted expansion of the antitrust laws does not affect only rate-regulated utilities; it could potentially apply to a broad range of business enterprises.

The brief in opposition to certiorari filed by the United States and the Federal Trade Commission ("DOJ/FTC Brief")[8] attempts to support the result below by a different line of reasoning than that of the lower court. In its discussion of the Sherman Act section 2 issue, this brief asserts that the complaint could be properly upheld if read to allege that "petitioners intended to assist AT&T [the cooperating supplier of removal services] in securing monopoly power." *Id.* at 18. This is true, in abstract legal theory. However, the DOJ/FTC Brief does not explain

[6] *Cf. Sutliff, Inc. v. Donovan Cos.*, 727 F.2d 648, 655 (7th Cir. 1984) (Posner, J.) ("[U]nfair competition, as such, does not violate the antitrust laws.") (citation omitted).

[7] *See, e.g., Parmelee Transp. Co. v. Keeshin*, 292 F.2d 794 (7th Cir. 1961), in which the court dismissed Sherman Act claims by a firm that lost business to competitors who allegedly bribed a public official to award the contract to them: "[T]he use of conventional antitrust language in drafting a complaint will not extend the reach of the Sherman Act to wrongs not germane to that act, even though such wrongs be actionable under state law . . . . The antitrust laws were never meant to be a panacea for all wrongs." *Id.* at 804, *cert. denied*, 368 U.S. 944 (1961).

[8] Brief for the United States and the Federal Trade Commission as Amicus Curiae On Petition For a Writ of Certiorari.

how it could possibly be in respondent's interest to confer monopoly power on a supplier or, indeed, why it would be necessary for respondent to exclude plaintiff from the market entirely, when it surely could simply direct its agents to buy exclusively from AT&T. *See Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 597 (1986) (an economically irrational argument "makes no practical sense").

The DOJ/FTC Brief does contain a discussion of why a regulated monopolist may choose to pay a higher price to a supplier which will "assist it in evading regulation." DOJ/FTC Brief at 10. This argument simply recognizes that a corrupt buyer may need to share the fruits of the fraud with its corrupt supplier, but the buyer still has no rational incentive to reward the supplier with monopoly profits as well. For one thing, a monopoly supplier would presumably be better able to resist payment of the "secret year-end 'rebate'" that AT&T supposedly paid to petitioner. Pet. App. 5a.

There also is no valid claim of competitive injury in the market for telephone services. Any overcharges paid by consumers in the market for telephone services arose not from competitive activity (termination of one supplier in favor of another) but from the fraudulent inflation of the telephone company's real costs. The effect on consumers would have been exactly the same if NYNEX had been able to get its original supplier Discon to cooperate in the fraudulent scheme, and it would then have been even more obvious that there is no plausible nexus to the antitrust laws.

The lower court makes no effort to explain how there could be a harmful effect in the market for telephone services. The DOJ/FTC Brief says that an agreement violates the Sherman Act section 1 when it "has the purpose and effect of enabling the monopolist to evade regulatory scrutiny *and exercise market power in a downstream market*." DOJ/FTC Brief at 12 (emphasis added).

But the DOJ/FTC Brief does not explain how the agreement in issue could possibly enable defendant to exercise market power in a downstream market—other than in a purely semantic sense. If evasion of regulatory oversight by artificial inflation of invoices can be said to facilitate the "exercise of monopoly power," so could the payment of bribes to regulators or any other falsification of books and records. Under the theory of the DOJ/FTC Brief, these should be antitrust offenses as well.[9] Again, the antitrust laws invade other areas of regulation.

This anomaly is highlighted by Respondent's Brief in Opposition which claims with satisfaction that defendant's scheme "has been adjudicated [in a rate proceeding] to have led to massive inefficiencies and harm to consumers," and that millions of dollars in rate reductions and rebates have been allowed. Brief of Respondent In Opposition to Petition For a Writ of Certiorari at 3. Since plaintiff-respondent has no standing to assert a claim for any injury to competition in the market for telephone services other than in its capacity as a consumer of these services, and since such consumers have apparently already obtained relief in the appropriate forum, it is hard to see what role antitrust has to play. *See* Pet. App. 32a (district court opinion holding that plaintiff's attempt to state a Sherman Act section 1 claim based on its standing as a ratepayer is barred by the filed rate doctrine).

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[9] It is true that evasion of price regulation may provide a plausible motivation for tying arrangements, reciprocity or "cross subsidization" between different product lines, and these kinds of conduct can be legitimate matters of antitrust concern if competitive injury is proved. *See* ROBERT H. BORK, THE ANTITRUST PARADOX 375-76 (1978). This motivation may therefore help an antitrust plaintiff counter arguments that the claimed conduct is inherently incredible or, alternatively, that the conduct is efficient and procompetitive. But, it is not the regulatory evasion that causes the competitive harm, if any; the plaintiff must prove harm from the conduct employed to implement the evasion.

In summary, the complaint pleads a serious fraud—and this brief does not, of course, defend the kind of conduct that is pleaded—but this is not an antitrust case.

II. IT IS BAD POLICY TO DISTORT ANTITRUST RULES IN ORDER TO PROVIDE REMEDIES AGAINST CONDUCT THAT IS OFFENSIVE FOR ANOTHER REASON.

It is evident from the face of the pleadings that regulatory remedies were available to remedy the wrongful evasion of telephone rate regulation that is asserted here. As stated in IX PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1712d, at 143 (1991):

> [T]he special remedy of treble damages was not created by Congress to enforce state or federal price ceilings. The appropriate damage and criminal remedies for violating a regulation are determined by the regulatory statute alone.

Judge Bork concurs in this analysis:

> Each body of law has its own purposes and its own scale of remedies and punishments. It is important to the integrity of the law that the wrongdoer not be convicted under any law that just happens to be handy, when his conduct does not in any way contravene the goals and rationale of that law.

ROBERT H. BORK, THE ANTITRUST PARADOX 381. Invocation of the antitrust laws here is not only unnecessary, but affirmatively harmful.

In recent years, this Court has been sensitive to the distortions in the legal system and in the economy that can arise from misapplication of antitrust remedies. It has attempted to avoid these harmful side effects by standing limitations, by evidentiary rules and by substantive doctrine. In *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), this Court held that indirect purchasers did not have standing to recover damages under section 4 of the Clayton Act, noting that to rule otherwise would make cases unmanageable and increase the risk of duplicative

recoveries.[10] *Id.* at 740 (to allow indirect purchasers to recover damages would transform treble damage actions "into massive multiparty litigations involving many levels of distribution and including large classes of ultimate consumers remote from the defendant").[11] Concern about possible economic distortions are reflected in the rulings in *Matsushita*, 475 U.S. at 594 ("[M]istaken inferences [regarding business behavior] . . . are especially costly because they chill the very conduct the antitrust laws are designed to protect."), and *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763 (1984) ("[p]ermitting an agreement to be inferred merely from the existence of complaints . . . could defer or penalize perfectly legitimate conduct"). These same concerns were evident in *Sharp*, 485 U.S. at 728 (application of the *per se* rule to vertical non-price restraints could cause manufacturers to forego legitimate and competitively useful conduct).

An earlier tying decision, *Fortner Enters. v. United States Steel Corp.*, 394 U.S. 495 (1969) (*Fortner I*), illustrates the problems this Court has since been careful to avoid. A developer claimed he could only qualify for the uniquely favorable financing terms offered by U.S. Steel if he agreed to buy U.S. Steel's inferior prefabricated houses. The tying "product" was thus the seller's extension of credit on its own houses! In *Fortner I*, this Court allowed the plaintiff to transmute what should have been a breach of warranty claim into an antitrust case. The decision was followed by the strange spectacle of a plaintiff supporting his antitrust claim at trial with evidence

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[10] There could well be problems involving standing, duplicative recovery and the filed rate doctrine in the present case if respondent Discon has been, or will be, reimbursed for telephone service overcharges.

[11] Limitations on standing to avoid economic distortion also may be found in *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487 (1977), and *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 116 (1986).

that the defendant had been particularly generous when extending him credit.[12]

When the case came back, in *Fortner II*,[13] the Court attempted to remedy manifest injustice in the case at hand by finding that the defendant U.S. Steel had no particular advantage in providing credit, but its previous ruling constrained the Court from revisiting the basic question of whether antitrust law should have been invoked in the first place. Tying law remained confused until *Jefferson Parish* was decided in 1984.[14]

Dealer termination cases provide another notorious example of contract disputes that are sometimes artificially crammed into an antitrust mold. Familiar principles of contract law, and special statutes requiring a manufacturer to deal in "good faith,"[15] are designed to redress perceived imbalances in bargaining power between dealers and their suppliers. Antitrust remedies are much more attractive, however, and therefore dealers are alert for any communications that may suggest a possible anti-competitive motivation for a termination that is essentially grounded on business differences.[16] An extreme instance is *Arnold Pontiac-GMC, Inc. v. General Motors Corp.*, 786 F.2d 564 (3d Cir. 1986), where a single inconclu-

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[12] Counsel of Record on this brief participated in that trial as one of the lawyers for defendant U.S. Steel.

[13] *United States Steel Corp. v. Fortner Enters.*, 429 U.S. 610 (1977).

[14] *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984).

[15] *E.g.*, Automobile Dealers' Day in Court Act, 15 U.S.C. § 1221(e).

[16] Antitrust litigation over termination of a dealer is much more common than litigation over termination of a supplier, which is involved here, not because there is necessarily a greater potential for competitive harm, but because dealers may be dependent on the relationship more frequently than suppliers are.

sive communication in 1980 was used to create an antitrust case out of a business dipute dating back to 1969.[17]

The present controversy also is not a legitimate antitrust case. As this Court has repeatedly emphasized in recent years, the antitrust laws should only be applied to conduct that genuinely threatens harm to the competitive process.

III. AFFIRMANCE OF THE DECISION BELOW HAS THE POTENTIAL TO CREATE SERIOUS CONFUSION AND DISTORTION.

The DOJ/FTC Brief concedes "that certain language in the court's opinion was not well-chosen." DOJ/FTC Brief at 6. Specifically, the DOJ/FTC Brief refers to the lower court's mistaken use of the term "group boycott" to characterize a situation where a buyer replaces one supplier with another. *Id.* The terminology is important because, as the DOJ/FTC Brief also recognizes, group boycotts have traditionally been deemed illegal *per se*, "without any further inquiry into . . . anticompetitive effects or procompetitive justification." *Id.* at 13.

The DOJ/FTC Brief attempts to minimize the significance of the lower court's mistake, however, by arguing that "this case turned on its particular facts and does not state any general rule. . . ." *Id.* at 6. The brief further claims that even though the lower court has used the terms "group boycott" and "*per se*" rule in a way that is "at odds with this Court's decisions," *id.* at 15, the error is not significant because the district court still has the opportunity to clear up the confusion.

> It is thus unclear whether the district court's inquiry on remand will differ significantly from traditional rule of reason analysis.

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[17] Compare the straightforward approach of the court in *Colsa Corp. v. Martin Marietta Servs., Inc.*, 133 F.2d 853 (11th Cir. 1998), when a terminated subcontractor attempted to invoke the antitrust laws by claiming the prime contractor monopolized its own contract: "Any rights that Colsa may have against Martin Marietta sound in contract instead of antitrust law." *Id.* at 856.

Id. at 16. Now that this Court has accepted the case for review, presumably the DOJ and the FTC would agree, at the very least, that the Court should specifically repudiate the lower court's idiosyncratic rationale.

But, as shown above, the lower court's decision is wrong for an even more fundamental reason: it does not plead a credible scenario of injury to competition. This infirmity is present not only in the opinion below, but also in the restatement of the court's holding offered by the DOJ/FTC Brief. Contrary to the principles expressly articulated by this Court in *Matsushita*, 475 U.S. at 587, the reasoning of the DOJ/FTC Brief necessarily suggests that courts may accept bare allegations of competitive harm at their face value, regardless of whether they make any economic sense.

In *Sharp*, 485 U.S. 717, this Court also rejected a plaintiff's attempt to avoid substantive requirements simply by pleading a *per se* offense. *Sharp* involved a claim that a discounting distributor had been terminated at the behest of another distributor, who was upset by plaintiff's price competition. However, the competitive effect of that action, standing alone, was no worse than the effect of an exclusive dealing arrangement—which, of course, should be analyzed under the rule of reason.

The Court was not misled by the assertion that the manufacturer's response to a price-related complaint was equivalent to vertical price fixing. It looked to basic economic reality, rather than characterizations in the pleadings, and insisted on proof of an effect beyond the mere substitution of one dealer for another.[18]

Respondent here, given ample opportunity, has been unable even to plead facts that show competitive harm. This infirmity would, of course, become even more ap-

[18] In *Sharp*, the complaint could not be summarily dismissed because there was some additional evidence of a genuine price-fixing agreement. *Id.* at 721.

parent in the course of a trial if the decision below were allowed to stand. But an antitrust defendant will derive scant comfort from the prospect of ultimate vindication after protracted pretrial proceedings and a possible trial. The threat of litigation costs, standing alone, can significantly deter pro-competitive behavior.

Antitrust "regulation" differs from some other kinds of regulation in that over-deterrence is particularly likely to do affirmative harm. To be sure, over-compliance with regulations of any kind may result in additional costs. But, over-deterrence in the antitrust area has the additional effect of chilling the continuous adjustments demanded by a competitive economy. In *United States v. United States Gypsum Co.*, 438 U.S. 422 (1978), this Court warned against "overdeterrence," which could cause businesses "to be excessively cautious in the face of uncertainty," *id.* at 441, and elaborated on the distinction between antitrust and other forms of regulation:

> [W]here the conduct prescribed is difficult to distinguish from conduct permitted and indeed encouraged, as in the antitrust context, the excessive caution spawned by a regime of strict liability will not necessarily redound to the public's benefit. The antitrust laws differ in this regard from, for example, laws designed to insure that adulterated food will not be sold to consumers. In the latter situation, excessive caution on the part of producers is entirely consistent with the legislative purpose.

Id. at 442 n.17 (citation omitted).

Unduly broad definitions of "predatory pricing" will inhibit aggressive, pro-consumer price competition. Similarly, undue expansion of antitrust remedies of the kind involved here can inhibit flexibility in the selection of suppliers or dealers. The precise conduct pleaded here may be rare. But if the decision below is affirmed, any other supplier or dealer could state a viable antitrust case simply by pleading that it had been terminated for an un-

worthy reason, without any plausible showing of injury to competition. If terminated suppliers or dealers can require a defendant to justify its actions simply by pleading that the process was corrupt or by pleading conclusory injuries to competition, contrary to economic common sense, courts and litigants will be burdened and the economy will become more rigid and less responsive to consumers.

CONCLUSION

This Court should reverse the judgment of the Second Circuit.

Respectfully submitted,

Of Counsel
ROBERT C. WEINBAUM
3031 West Grand Boulevard
Detroit, Michigan 48202

THOMAS B. LEARY *
WILLIAM L. MONTS, III
LYNDA K. MARSHALL
HOGAN & HARTSON L.L.P.
Columbia Square
555 Thirteenth Street, N.W.
Washington, D.C. 20004-1109
(202) 637-5600

* Counsel of Record

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISES COMPANY, and NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON, INCORPORATED,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF *AMICUS CURIAE* GTE CORPORATION IN SUPPORT OF PETITIONERS

WILLIAM P. BARR
WARD W. WUESTE, JR.
M. EDWARD WHELAN III
GTE SERVICE CORPORATION
1850 M Street, N.W.
Washington, D.C. 20036
(202) 463-5200

CHRISTOPHER LANDAU
Counsel of Record
PAUL T. CAPPUCCIO
JOHN P. FRANTZ
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 879-5000

Counsel for Amicus Curiae GTE Corporation

June 1, 1998

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QUESTIONS PRESENTED

The questions presented in the Petition for a Writ of Certiorari, on which the Court granted review, are:

When a Purchaser agrees to buy from Supplier A rather than Supplier B, and there is no issue of any horizontal restraints or vertical price restraints:

1. May the agreement between Purchaser and Supplier A be characterized as a group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?

2. May the agreement between Purchaser and Supplier A be characterized as a conspiracy to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2?

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On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF *AMICUS CURIAE* GTE CORPORATION IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

GTE Corporation has various subsidiaries (collectively, "GTE") that offer local telephone service to millions of customers throughout 28 States. GTE also offers long distance, data, and wireless services, as well as many other telecommunications products, to customers across the Nation.[1]

To deliver voice and data telephony to its customers, GTE must build, operate, and maintain vast and highly complex telecommunications networks. To provide local telephone service to a single city, for example, GTE must build lines that branch out from a central office to every single business and

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[1] Pursuant to Rule 37.6, GTE Corporation states that this brief was not prepared, written, funded, or produced by any person or entity other than GTE Corporation or its counsel. Letters reflecting written consent of the parties to the submission of this brief have been filed with the Clerk of the Court.

residence, and must connect all of these lines with a series of switches that route calls to desired destinations. Even this small local network requires constant monitoring and management by personnel who do everything from processing new orders to resolving trouble reports from customers.

No telecommunications provider could operate a business of this complexity without buying products and services — from the pens and paper clips needed to furnish its offices to the fiber-optic cables needed to connect its customers — from thousands of different vendors. And frequently, the most efficient method of acquiring these goods and services is by entering into exclusive agreements with individual suppliers.

GTE, like many other businesses, has long been able to enter into such agreements secure in the knowledge that they would be subjected to antitrust scrutiny, if at all, only under a deferential rule of reason. The decision below destroyed that certainty by holding that some *vertical* nonprice agreements could be deemed *horizontal* group boycotts (and hence *per se* illegal), and by suggesting that an alleged regulatory violation in a downstream market might violate the antitrust laws, even in the absence of any demonstrated antitrust injury to the plaintiff.

As a result, the Second Circuit has undermined GTE's ability to plan its business rationally and efficiently, and exposed the company to a risk of litigation — and treble damage liability — for negotiating agreements that have long been afforded great solicitude under the antitrust laws. GTE therefore has an interest in urging this Court to reverse the judgment below.

INTRODUCTION

The decision below drew upon idiosyncratic facts to overturn long-settled principles of antitrust law. The agreement at issue here — allegedly motivated by a local telephone company's desire to pass on excessive costs to captive

ratepayers — could have come about only where a monopolist subject to rate-of-return regulation is on the buying end of an exclusive supply contract. This factual scenario is now largely obsolete, both because state and federal regulators have largely eliminated rate-of-return regulation, and because the introduction of competition into local telephone markets (and many other markets previously served by regulated monopolists) now precludes carriers from passing excessive charges on to customers. Nevertheless, the Second Circuit shoehorned this unlikely vertical agreement into an inapplicable horizontal category of *per se* illegality. By so doing, that court established a broad rule that calls into question an extraordinary number of once-permissible vertical nonprice agreements, and created an intolerable level of uncertainty with respect to the lawfulness of exclusive supply contracts.

That uncertainty is vastly magnified by the fact that the decision below failed to establish any workable standard for identifying when the new *per se* standard should apply. The Second Circuit held not only that two-party vertical agreements could be condemned as *per se* illegal horizontal group boycotts when they have horizontal effects (as do all exclusive supply contracts), but also that this draconian standard could apply whenever no "pro-competitive rationale [for the agreement] appears on the face of the complaint." Pet. App. 12a. The new vertical *per se* rule announced below is therefore limited only by the ability of the plaintiffs' bar to draft artful complaints, omitting allegations unhelpful to any plaintiff's case. This "standard" is no standard at all, and threatens to undermine this Court's command that the evidentiary standards of the antitrust laws must not "deter or penalize perfectly legitimate conduct." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763 (1984).

SUMMARY OF ARGUMENT

1. In an unbroken line of cases over the past two decades, this Court has made clear that *all* vertical nonprice agreements are subject to antitrust scrutiny under the deferential rule of reason rather than any rigid rule of *per se* illegality. Beginning with *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), this Court has consistently held that any anticompetitive effects "from particular vertical restrictions . . . can be adequately policed under the rule of reason." *Id.* at 59. That principle was reaffirmed in *Monsanto*, 465 U.S. at 761, *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 724-26 (1988), and (most recently) in *State Oil v. Khan*, 118 S. Ct. 275, 279-84 (1997).

The decision below marked a clear and unwarranted departure from this controlling authority. Although the Second Circuit recognized that the contract at issue here was "an agreement between two firms . . . in a vertical relationship," it nevertheless held that some such agreements could be characterized as a *per se* illegal horizontal group boycott if the "intent and effect" of the agreement is "to disadvantage the direct competitor . . . of one of the conspiring firms." Pet. App. 10a-11a (citing *Klors, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959)).

A vertical agreement, however, cannot be transmogrified into a horizontal restraint of trade simply because "it has horizontal effects." *Business Electronics*, 485 U.S. at 731 n.4. *All* vertical nonprice agreements, regardless of whether they have horizontal effects, must be judged under the rule of reason. *See, e.g., State Oil*, 118 S. Ct. at 281. The decision below cannot be squared with these precedents.

Indeed, it would make little sense to use this case as the vehicle for announcing a new category of *per se* illegal vertical agreements. There is no reason to think that businesses generally have any incentive to enter into agreements to

purchase exclusively from high-cost suppliers. This case is unusual because, at the time of the challenged conduct, petitioners were regulated monopolists who allegedly sought to evade rate-of-return regulation by inflating the charges passed on to ratepayers. Legislative and market developments, however, have rendered this factual scenario largely obsolete. Congress opened the market for local telephone service to competition by enacting the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (codified throughout 47 U.S.C.), as part of a broader trend of introducing competition to markets once controlled by regulated monopolists. Not only will the discipline of competition keep any previously-regulated utilities from passing on excessive charges to consumers, but a battery of regulatory enforcement mechanisms are already in place to foil any such scheme. No new *per se* rule is either necessary or appropriate in this swiftly changing area.

2. The United States and the Federal Trade Commission fare no better in endorsing a heightened standard of review, rather than the rule of reason, for assessing whether the agreement challenged here violates the Sherman Act. Under such a heightened standard, the defendant would have to establish a pro-competitive justification for its conduct *before* the plaintiff was required to carry its burden of proving that the agreement threatened any anticompetitive injury. *See also* Pet. App. 12a (suggesting that the first step in deciding whether a vertical agreement violated the Sherman Act was to scrutinize "the business justifications for the agreement").

This approach, which effectively reverses the burden of proof, has been applied only in cases involving a "naked" horizontal restriction on price or output. *See, e.g., FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 460 (1986); *NCAA v. Board of Regents*, 468 U.S. 85, 109-10 (1984). It has never been extended to a case involving a vertical agreement, for the simple reason that vertical agreements are presumptively lawful.

Such a heightened standard, if endorsed here, would permit antitrust plaintiffs to proceed to trial without offering *any* evidence that a vertical nonprice agreement had *any* anticompetitive effects, and would thereby open the floodgates to strike lawsuits challenging legitimate business decisions.

3. Analyzed under the rule of reason, respondent's complaint must be dismissed as a matter of law. Only those restraints that threaten the creation or exercise of monopoly power in a given market (here, the market for telephone equipment removal services) are unreasonable and hence unlawful. Although the complaint challenges petitioners' motives for entering into an exclusive contract with another supplier (AT&T), that challenge alone is not enough to establish an unreasonable restraint of trade. Rather, to satisfy this standard, respondent must also allege that it would have received more business from petitioners — *i.e.*, that the exclusive agreement reached between petitioners and AT&T would not have been reached — in a competitive market.

The antitrust laws, as this Court has emphasized time and again, protect "competition, not competitors." *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (citation omitted). It is the very essence of a free-market economy that some firms will lose business to other firms. Such a loss does not, in and of itself, implicate any antitrust injury, even where the losing firm goes out of business. Nothing in respondent's complaint negates the possibility that AT&T was the more efficient supplier of removal service, and therefore that respondent suffered no antitrust injury by losing business to AT&T. In the absence of such an allegation, respondent has alleged nothing more than a regulatory violation in a downstream market — an injury that it has no standing to raise, and that is policed by a comprehensive regulatory regime. Respondent, in short, has at most alleged a violation of telecommunications regulations rather than the antitrust laws.

The Second Circuit therefore erred by reversing the district court's judgment dismissing the complaint.

ARGUMENT

I. EXCLUSIVE SUPPLY AGREEMENTS INVOLVING REGULATED INDUSTRIES SHOULD NOT BE DEEMED *PER SE* ILLEGAL.

In an unbroken line of cases over the past twenty years, this Court has repeatedly reaffirmed the principle that vertical nonprice agreements are not *per se* illegal, but must be evaluated under the rule of reason. *See State Oil*, 118 S. Ct. at 281 (case law rejects the "application of a *per se* rule in the context of vertical nonprice restrictions"); *Business Electronics*, 485 U.S. at 724 (the Court has "refused to extend *per se* illegality to vertical nonprice restraints"); *Monsanto*, 465 U.S. at 761 ("[C]oncerted action on nonprice restrictions . . . [is] judged under the rule of reason."); *GTE Sylvania*, 433 U.S. at 58 (rejecting antitrust claim where no showing made "that vertical restrictions have or are likely to have a 'pernicious effect on competition'") (citation omitted).

Notwithstanding this line of cases, the Second Circuit held that two-party vertical agreements — *i.e.*, all exclusive supply contracts — are properly analyzed as *per se* illegal horizontal group boycotts if the "intent and effect" of the agreement is "to disadvantage the direct competitor . . . of one of the conspiring firms." Pet. App. 10a-11a (citing *Klors*, 359 U.S. at 211-12). That conclusion has no basis in law or economic reality.

Indeed, the Second Circuit's approach would altogether obliterate the distinction between vertical and horizontal restraints, "since all anticompetitive effects are by definition horizontal effects." *Business Electronics*, 485 U.S. at 730 n.4. That is precisely why this Court has expressly rejected the notion that vertical agreements with horizontal effects can be reclassified as horizontal restraints. Any such effort would only

"introduce[ ] needless confusion into antitrust terminology," and would defeat the common-sense rule that "[r]estraints imposed by agreement between competitors have traditionally been denominated as horizontal restraints, and those imposed by agreement between firms at different levels of distribution as vertical restraints." *Id.* at 730. The court below simply ignored this Court's teaching that "a restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement." Id. at 731 n.4; *see also* ABA Section of Antitrust Law, *Statement on Discon v. NYNEX* at 4-5 ("Characterizing a vertical agreement as horizontal because it has horizontal effects . . . contradicts at least eighty years of antitrust jurisprudence and deprives courts and businesses of a clear rule that has long assisted the adjudication of antitrust cases and the determination of what conduct runs afoul of the antitrust laws.") (visited May 28, 1998) (http://www.abanet.org/antitrust/discon.html).

There is no basis for applying a *per se* rule of illegality to vertical nonprice agreements. Rules of *per se* illegality are the exception, not the norm, in antitrust analysis. *See, e.g., State Oil*, 118 S. Ct. at 279. As this Court has explained, such rules are applied only to limited categories of restraints that have "predictable and pernicious anticompetitive effect," and "limited potential for procompetitive benefit." *Id.* Except in these narrow categories, the default rule of reason applies. *See id.*; *see also GTE Sylvania*, 433 U.S. at 58-59 ("[D]eparture from the rule-of-reason standard must be based upon demonstrable economic effect.").

There is simply no basis for applying a rule of *per se* illegality to the vertical nonprice agreement challenged here. As this Court has noted, vertical agreements are "widely used in our free market economy." *GTE Sylvania*, 433 U.S. at 57. The Second Circuit made no attempt to determine that exclusive supply contracts have "predictable and pernicious anticompetitive effects" and "limited potential for

procompetitive benefits" so as to warrant the establishment of a *per se* rule of illegality. Quite the contrary is true: the settled rule has long been that a buyer of goods or services is free to buy from the supplier of its choice and to set the terms on which it will deal. *See, e.g., United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919) ("A retail dealer has the unquestioned right to stop dealing with a wholesaler for reasons sufficient to himself.") (citation omitted).

Indeed, it is hard to see how the Second Circuit's novel rule of *per se* illegality would combat "predictable and pernicious anticompetitive effects" in the economy as a whole. A buyer of goods or services generally has no incentive to enter into an agreement to buy exclusively from a higher-cost supplier — in our free market system, any scheme to pass on inflated prices to customers is doomed to failure. The scheme alleged here could work only where (as was true here at the time of the challenged agreement) the defendant is a monopoly subject to rate-of-return (or "cost-plus") regulation.

But these regulated monopolies are already subject to comprehensive oversight to ensure that they do not pass on inflated costs to consumers. The FCC and most state public utility commissions have abandoned rate-of return regulation in favor of price-cap regimes.[2] Under the old cost-plus system, local carriers arguably had an incentive to overstate their costs because their level of return was pegged directly to their costs of providing local service. Recognizing the potential

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[2] Local carriers receive two different types of compensation for operating their networks. First, they are paid directly by local customers for the use of their local networks. These intrastate charges are regulated by state public utility commissions. Second, local carriers are paid by long distance providers for the right to terminate calls on their local networks. These "access charges," which are ultimately passed on to long distance customers, are regulated by the FCC. *See* First Report and Order, *Access Charge Reform*, 12 F.C.C.R. 15982 ¶ 7 (1997) (hereinafter *Access Charge Reform Order*).

disadvantages of this system, the FCC and state commissions replaced rate-of-return regulation with a price cap regime that limits the prices "carriers may charge" for local service, and treats "most changes in a carrier's costs . . . as 'endogenous,' which means that they do not result in adjustments to the carrier's price cap indices." Order, *Accounting Safeguards Under the Telecommunications Act of 1996*, 11 F.C.C.R. 17539 ¶ 259-60 (1996). Consequently, local carriers are denied any opportunity to overcharge for local service, because these price cap rules keep them from recovering costs unfairly allocated to local service.

Moreover, local telephone companies must comply with highly detailed accounting rules governing the charges that can be passed on to customers. *See* 47 C.F.R. § 32.1 *et seq.* (providing an exclusive list of costs that can be allocated to a carrier's provision of local telephone service). The FCC and state public utility commissions also investigate any complaints against a local carrier for overcharging customers, and have the power to issue large fines against carriers that pass on inflated costs. Indeed, administrative proceedings were initiated against petitioners, resulting in a settlement that required multi-million dollar payments to ratepayers and the federal government. *See* Order, *New York Telephone Co. & New England Tel. & Tel. Co., Apparent Violations of the Commission's Rules and Policies Governing Transactions with Affiliates*, 5 F.C.C.R. 5892 (1990).

In any event, it would be the height of irony for this Court to announce a new antitrust rule of *per se* illegality limited to regulated industries at the very moment in history when such industries are for the first time being opened up to competition. *See, e.g.*, John B. McArthur, *Anti-Trust in the New [De]Regulated Natural Gas Industry*, 18 Energy L.J. 1, 6 (1997) ("In market after market, from airlines to banking, trucking to telephones, electricity to natural gas, the cost-of-service edifice has been wholly or partly dismantled."). In the

market for local telephone service, for example, the Telecommunications Act of 1996 was expressly designed to open local markets to competition. Section 253(a) of the Act revoked all state-granted monopoly franchises held by local providers, and sections 251-52 established multiple avenues for competitive entrants to begin offering local service. *See* 47 U.S.C. §§ 251-53; *see also Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 791-92 (8th Cir. 1997), *cert. granted*, 118 S. Ct. 879 (1998). The Act has therefore effectively stripped local carriers of any hypothetical ability to overcharge ratepayers by passing on inflated costs, because any carrier that did so would see its market share swiftly diminish. *See Access Charge Reform Order* ¶ 280 (any effort to pass on excessive costs to local customers is "likely to induce substantial additional entry in local markets").

It is neither necessary nor appropriate, in short, for this Court to declare exclusive supply agreements *per se* illegal in the limited context of regulated industries. The flexible rule of reason is more than up to the task of policing the antitrust implications of such agreements. The Second Circuit held otherwise only by blurring the bedrock distinction between horizontal and vertical restraints that is a core analytical tenet of modern antitrust law. *See* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1644c at 727-28 (1997 Supp.) (criticizing the Second Circuit's decision because the "purpose of the *per se* rule dispensing with proof of power and effects is not to turn fraud claims — even those deceiving consumers and causing higher prices — into antitrust violations"). This Court should restore clarity to this important area of the law by reaffirming that distinction and the corollary principle that vertical nonprice restraints are subject to antitrust analysis under the rule of reason.

II. EXCLUSIVE SUPPLY AGREEMENTS INVOLVING REGULATED INDUSTRIES SHOULD NOT BE SUBJECTED TO HEIGHTENED ANTITRUST SCRUTINY.

The United States and the Federal Trade Commission pointedly decline to defend the Second Circuit's adoption of a *per se* rule of illegality, but suggest that an analogous heightened standard of antitrust review, rather than conventional rule-of-reason analysis, might apply. *See* Brief for the United States and the Federal Trade Commission as Amici Curiae at 16-17; *see also* Joel I. Klein, *Review of Horizontal Agreements — Procompetitive Effects*, 7 Trade Reg. Rep. (CCH) ¶ 50,157, at 49,191 (Nov. 7, 1996). In particular, the Government endorses the Second Circuit's assertion that antitrust liability should be presumed in the absence of any evident "pro-competitive rationale" for the challenged agreement. Pet. App. 12a. Under the Government's approach, a defendant would be required to establish a pro-competitive justification for a challenged agreement *before* the plaintiff was required to establish the agreement's anticompetitive effects.

That approach is wholly unwarranted in this case. Such heightened scrutiny has been applied only to uniquely anti-competitive *horizontal* restraints. *See Indiana Fed'n of Dentists*, 476 U.S. at 460 ("As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output.") (citation omitted); *NCAA*, 468 U.S. at 110 ("This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis."); *see also* Joel I. Klein, *A "Stepwise" Approach for Analyzing Horizontal Agreements Will Provide a Much Needed Structure for Antitrust Review*, Antitrust, Spring 1998, at 42 ("[T]he stepwise approach . . . applies only to horizontal agreements that directly limit competition."). But this heightened standard has *never* been applied to any type of *vertical* agreement. Applying this standard, rather than the

default rule of reason, to vertical nonprice agreements is wholly unwarranted for the very same reasons that a *per se* rule of illegality is unwarranted — there is no reason to assume that vertical nonprice agreements are anticompetitive.

Indeed, importing this heightened horizontal standard into the vertical sphere will do nothing but "deter or penalize perfectly legitimate conduct." *Monsanto*, 465 U.S. at 753. This standard effectively reverses the burden of proof in antitrust cases, requiring the defendant to justify its conduct before putting the plaintiff to its proof of anticompetitive injury. By turning the ordinary antitrust burden of proof upside down, this standard allows plaintiffs to proceed to trial without offering *any* evidence that the challenged agreement has *any* anticompetitive effects. Unless and until the plaintiff proves such effects, there is simply no basis to impose antitrust liability for vertical nonprice agreements. Unless and until the plaintiff satisfies this burden, the defendant need not proffer any "business justifications" or "pro-competitive rationale" for the agreement. Pet. App. 12a. The Government's burden-shifting approach, if embraced by this Court, would give an extraordinary new weapon to disappointed bidders for exclusive contracts, and create an intolerable threat that legitimate, efficient business decisions will be deterred by the threat of strike lawsuits.

III. THE VERTICAL SUPPLY AGREEMENT AT ISSUE HERE SATISFIES THE RULE OF REASON.

Every commercial agreement, particularly an exclusive supply contract, restrains trade in some limited sense. *See Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289 (1985). By agreeing to buy an input from only one seller, a buyer restricts the universe of purchasers available to other suppliers in the market. But section 1 of the Sherman Act does not prohibit all such agreements, the great majority of which have profoundly pro-

competitive effects. Section 1 prohibits only unreasonable restraints of trade. *See State Oil*, 118 S. Ct. at 279.

To determine whether a challenged agreement satisfies the rule of reason, a finder of fact must take "into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect." *Id.* Ultimately, the rule of reason condemns only those restraints that threaten the creation or exercise of monopoly power "in a properly defined relevant market." Areeda, *supra*, at 727.

Here, the relevant market is the one in which respondent participates — the market for telephone equipment removal services — not the downstream market for local telephone service. Although respondent's complaint alleges that petitioners used their market power to overcharge purchasers of local telephone service, respondent lacks standing even to raise that claim. *See Kansas v. Utilicorp United, Inc.*, 497 U.S. 199, 205, 207 (1990) (only "immediate buyers from the alleged antitrust violators" have standing to sue for inflated utility charges, not entities suing in "*parens patriae*"). Moreover, not every action that has the effect of raising prices violates the Sherman Act. The antitrust laws are concerned with competition, not the overall business practices of regulated industries. Any injury suffered by telephone ratepayers is policed not by the antitrust laws, but by the comprehensive regulatory regime governing the rates of local telephone carriers. *See supra* at 9-10. This Court should not allow the Sherman Act to swallow up the rest of the U.S. Code.

Under a proper rule-of-reason analysis, the key question is whether respondent has alleged any anticompetitive conduct in the market for telephone equipment removal services. When viewed through this lens, it is clear that respondent's complaint alleges only a plain-vanilla violation of telecommunications

regulations rather than an unreasonable restraint of trade in violation of the antitrust laws.

To establish an unreasonable restraint of trade, a supplier must do more than allege that it lost an opportunity to serve a buyer — otherwise, disappointed bidders for every exclusive contract would have a cause of action. Indeed, it is axiomatic that antitrust laws are concerned not with whether one competitor or another succeeds in the marketplace, but whether competition is harmed generally. *See Brunswick Corp.*, 429 U.S. at 488.

This limitation must be enforced with particular rigor in markets where the demand for a particular service is limited. Telecommunications carriers (and other regulated utilities) often require services not demanded by other consumers — the market for telephone removal services is a case in point. In such cases, a buyer's decision to negotiate an exclusive supply agreement may leave other suppliers without enough demand to sustain their business, effectively driving them out of the market. Nonetheless, it is the buyer's prerogative to buy from the supplier of its choice and to set the terms on which it will deal. *See Colgate*, 250 U.S. at 307.

Although respondent's complaint challenges petitioners' motives for entering into an exclusive contract with AT&T, that challenge alone is not enough to establish an unreasonable restraint of trade in the market for telephone removal services. *First*, respondent must also allege some kind of market-wide restraint that has a broader competitive impact than simply precluding one supplier from offering service to one particular customer. *Second*, respondent must allege that there are barriers to entry in the market for removal services that would permit an anticompetitive restraint to have some lasting anticompetitive effect. *Third*, respondent must establish that it would have received more business from petitioners — *i.e.*, that

the exclusive agreement reached between petitioners and AT&T would not have been reached — in a competitive market.

Respondent's complaint does not include any of these necessary allegations, which cannot be assumed or inferred from the fact that respondent lost business. Petitioners may have had legitimate business reasons (over and above any improper motive) to purchase removal services exclusively from AT&T. For example, aggregating removal business in one firm could allow petitioners to benefit from economies of scale or could decrease the administrative costs associated with contracting for removal services over a large territory.

Indeed, even assuming hypothetically that a carrier might hope to buy removal services at inflated prices and demand a secret rebate, its incentives in selecting an exclusive removal services supplier would be identical to those it would face in a competitive market. On one hand, selecting an inefficient supplier of removal services would only limit the size of the rebate the carrier could receive. On the other hand, selecting the most efficient supplier would maximize the amount of the surplus created by the scheme — maximizing the carrier's return. Although it is possible that the carrier might select a less efficient provider if the market leader refused to offer rebates, it is nevertheless an essential element of the passed-over supplier's claim that it was the superior provider of removal services. Otherwise, the losing supplier has suffered no antitrust injury — it was vanquished because it was the lesser competitor, not because it refused to offer secret rebates.

Respondent's complaint fails on this ground, because it does not allege that petitioners would have acted any differently in a competitive market. The complaint alleges nothing more than a scheme by petitioners to inflate the rates they charge their local telephone customers. To state a claim under the Sherman Act, respondent must allege more. It must allege some injury cognizable under the antitrust laws — something more than a

simple fraud or regulatory violation resulting in higher prices for downstream consumers. Any other rule would transform the antitrust laws into a all-purpose code of business regulation.

CONCLUSION

For all the foregoing reasons, as well as those set forth in petitioners' brief, the judgment below should be reversed.

Respectfully submitted,

WILLIAM P. BARR
WARD W. WUESTE, JR.
M. EDWARD WHELAN III
GTE SERVICE CORPORATION
1850 M Street, N.W.
Washington, D.C. 20036
(202) 463-5200

CHRISTOPHER LANDAU
Counsel of Record
PAUL T. CAPPUCCIO
JOHN P. FRANTZ
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 879-5000

Counsel for Amicus Curiae GTE Corporation

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In the

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October Term, 1997

NYNEX CORPORATION,
NYNEX MATERIEL ENTERPRISES COMPANY,
and NEW YORK TELEPHONE COMPANY,

Petitioners,

v.

DISCON, INCORPORATED,

Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Second Circuit

BRIEF OF *AMICI CURIAE* LAW PROFESSORS IN SUPPORT OF RESPONDENT

WARREN S. GRIMES
Southwestern University
School of Law

STEPHEN F. ROSS
University of Illinois
College of Law

MARK R. PATTERSON
Counsel of Record
Fordham University
School of Law
140 West 62nd Street
New York, New York 10023
(212) 636-7867

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CONSENT OF PARTIES

Petitioners and respondent have consented to the filing of this brief *amici curiae*.[1]

INTEREST OF *AMICI*

This brief *amici curiae* is submitted on behalf of a group of law professors in the United States.[2] As teachers and scholars of antitrust law, the *amici* are interested in the proper interpretation and application of the federal antitrust laws. The *amici* have received no compensation or promise of compensation for submitting this brief. They submit it solely because they believe that the Second Circuit's view that a vertical agreement with an obvious effect on interbrand competition should be subject to close antitrust scrutiny is correct and that adoption of the petitioners' position that all vertical nonprice agreements require identical analyses under a "full-blown" rule of reason would impede the functioning of the federal antitrust laws.

SUMMARY OF ARGUMENT

1. Both of the lower courts interpreted the complaint in this case to allege that the petitioner NYNEX and a co-conspirator, AT&T Technologies, agreed to eliminate the respondent Discon from the market. If this Court disagrees

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[1] Their written consents have been filed with the clerk of this Court. This brief was written by the *amici curiae* listed on its cover; it was not written in whole or in part by counsel for a party. No one other than the *amici* and their institutions made any monetary contribution to the preparation or submission of this brief.

[2] The law professors are listed in an appendix to this brief.

and concludes that the complaint does not adequately allege an agreement to eliminate Discon from the market, as distinguished from an agreement simply to terminate the relationship between NYNEX and Discon, it should either remand the case to the lower courts, directing them to treat it as a simple supplier termination, or make clear that its holding would not necessarily be applicable to a case that properly alleged the elimination of a competitor.

2. This Court has said that vertical agreements are usually treated more leniently than horizontal agreements because vertical agreements, unlike horizontal ones, often promote interbrand competition. It follows that a vertical agreement that does not promote interbrand competition does not deserve lenient treatment.

An agreement between a firm and its supplier or dealer to eliminate another supplier or dealer might have any of several purposes. First, the agreement might be intended by the firm in the interbrand market to deny its competitors access to the eliminated supplier or dealer. Second, the agreement might be intended by the conspiring supplier or dealer to eliminate intrabrand competition from the eliminated supplier or dealer; in that case, the conspiring supplier or dealer might coerce the participation of the firm at the interbrand level in the agreement. Third, the agreement might be directed at some other purpose, perhaps unrelated to the usual concerns of antitrust; in the present case, that other purpose might have been regulatory fraud. Regardless of which of these purposes is intended, the agreement injures both intrabrand and interbrand competition, and therefore should be treated harshly under the antitrust laws.

3. This Court has on at least two occasions held defendants subject to § 1 liability on *per se* theories in cases where those defendants entered into no agreements with other firms at their level. In *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the *per se* liability was justified because the apparent purpose of the vertical agreements at issue was to eliminate a competitor. In *United States v. General Motors Corp.*, 384 U.S. 127 (1966), which involved only the termination of relationships with competitors, not their elimination from the market, the *per se* liability was justified by the coercion that apparently prompted the termination. Both of these cases support the view that some vertical agreements—specifically, those that do not benefit interbrand competition—are treated harshly under the antitrust laws.

4. It is not difficult to distinguish between agreements to eliminate competitors from the market and agreements simply to terminate suppliers or dealers. The essential difference is that an agreement to eliminate a competitor from the market goes beyond the relationships between the targeted competitor and the conspiring firms to make it more difficult for the targeted competitor to do business with other market participants. The adoption by this Court of harsh treatment for agreements that meet this or a similar test would provide the lower courts with useful guidance in assessing vertical agreements.

ARGUMENT

I. IF THE COMPLAINT DOES NOT ADEQUATELY ALLEGE AN AGREEMENT TO ELIMINATE DISCON FROM THE ENTIRE REMOVAL-SERVICES MARKET, THIS COURT SHOULD DIRECT THAT THE CASE BE TREATED AS A SIMPLE SUPPLIER TERMINATION.

The complaint in this case alleges that NYNEX, though its subsidiary MECo, and AT&T Technologies "took concerted action to drive Discon from the market." Amended Complaint ¶ 2, J.A. 76; *see also* Amended Complaint ¶ 33, J.A. 84. That is, the complaint alleges that the conspirators' goal was to eliminate Discon entirely as a seller of removal services, not just to terminate its status as a supplier to NYNEX. Both of the lower courts adopted this interpretation of the complaint. *See* App. to Pet. for Cert. 24a (district court), 4a (court of appeals); *but see* App. to Pet. for Cert. 28a (district court).

Whether the complaint alleges facts sufficient to support its allegation of an agreement to eliminate Discon from the market is unclear. Most of the specific factual allegations are as consistent with a simple termination by NYNEX of its relationship with Discon as they are with an attempt to eliminate Discon from the market entirely.[3] *See, e.g.,*

[3] There are two possible exceptions. First, Discon alleges that NYNEX made false statements to state and federal regulators. See Amended Complaint ¶¶ 33(a), 50, J.A. 85, 90. However, these statements appear to have been made in an attempt by NYNEX to defend its decisions not to contract with Discon, not in an independent effort to harm Discon. See Amended Complaint ¶¶ 33(a), 47, 55, 110, J.A. 85, 89, 91, 112.

(continued...)

Amended Complaint ¶ 33, J.A. 84-86. Although the complaint does allege that Discon was driven out of business, Amended Complaint ¶ 58, J.A. 92, that may have been merely the consequence of a termination of its relationship with NYNEX, not the purpose of an agreement between NYNEX and AT&T Tecnnologies. The termination of a supplier by a monopolist like NYNEX may often have the effect of causing the supplier to go out of business, but this causal relationship alone does not transform an agreement to terminate a supplier into an agreement to eliminate it from the market.

If this Court decides that Discon does not sufficiently allege that NYNEX and AT&T Technologies sought to eliminate it from the market, the Court should return the case to the lower courts, directing them to treat it as alleging a simple supplier termination. This would be appropriate in that the competitive concerns of the Second Circuit below appear to have been focused on the elimination issue. *See* App. to Pet. for Cert. 15a ("Discon alleges that MECo sought the dominance of AT&T Technologies in order to ensure the suppression of other suppliers . . . ."). Alternatively, if the Court chooses either to direct the lower courts to evaluate the case under the rule of reason or to dismiss the case, it should

[3] (...continued)

Second, Discon alleges that a NYNEX employee forced it to commit fraudulent acts that harmed a third-party scrap buyer. Amended Complaint ¶¶ 74-75, 89, J.A. 103, 108. These acts would presumably have harmed Discon's relationship with the scrap buyer and thus its position in the market. But Discon does not allege that NYNEX forced it to commit these acts as part of an agreement with AT&T Technologies; so far as the complaint alleges, the scheme was a unilateral one on the part of NYNEX or the NYNEX employee.

make clear that its decision might have been different had Discon properly alleged an agreement to eliminate a competitor. Consistent with this Court's decisions in related areas of antitrust law, *see Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 760-64 (1984), the Court could require that a plaintiff bringing allegations like Discon's present evidence of conduct that is inconsistent with a decision simply to terminate a business relationship. *See infra* part IV.

II. AN AGREEMENT TO ELIMINATE A COMPETITOR FROM AN ENTIRE MARKET HAS NO PROCOMPETITIVE BENEFITS AND THEREFORE SHOULD BE JUDGED MORE HARSHLY THAN AN AGREEMENT TO TERMINATE A BUSINESS RELATIONSHIP, WHETHER THE AGREEMENT IS CHARACTERIZED AS HORIZONTAL OR VERTICAL.

A complaint that adequately alleges an agreement to eliminate a competitor from an entire market alleges conduct that this Court has repeatedly condemned. *See Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (Sherman Act § 2 case, but with Sherman Act § 1 claims); *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 213 (1959); *Fashion Originators' Guild of America, Inc. v. F.T.C.*, 312 U.S. 457, 461, 467 (1941). *Cf. United States v. General Motors Corp.*, 384 U.S. 127, 146 (1966) ("Exclusion of traders from the market by means of combination or conspiracy is so inconsistent with the free-market principles embodied in the Sherman Act that it is not to be saved by reference to the need for preserving the collaborators' profit margins or their system for distributing [their products] . . . .").

A. Section 1 of the Sherman Act Does Not Distinguish Between Horizontal and Vertical Agreements, so Differences in Treatment of the Two Kinds of Agreements Should Be Based on Substantive Effects, Not Formal Categorizations.

Section 1 of the Sherman Act refers to contracts, combinations, and conspiracies in restraint of trade, not to horizontal and vertical agreements. This Court has treated vertical agreements more leniently not because they are formally vertical, but because many vertical agreements have more procompetitive potential than do horizontal agreements. In *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), where the Court established the rule that most nonprice vertical restraints would be judged under the rule of reason, it did so because vertical restraints have the "potential" to promote interbrand competition, *id.* at 51, and the Court said that "[t]hese 'redeeming virtues' are implicit in every decision sustaining vertical restrictions under the rule of reason," *id.* at 54.

It follows that where such "redeeming virtues" are absent, even vertical agreements should not be treated with deference.[4] For that reason, *Sylvania* did "not foreclose the possibility that particular applications of vertical restrictions might justify *per se* prohibition." *Id.* at 58. This emphasis on substance was not altered in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988). Although the

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[4] Conversely, even horizontal agreements that literally involve the fixing of prices are judged leniently if they have the potential to improve the price and/or quality of goods and services to consumers. *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979).

Court in *Business Electronics* rejected the characterization of a formally vertical agreement as horizontal, *id.* at 730 n.4, it did not say that all vertical relationships must be treated the same. Indeed, the case re-affirmed the *per se* rule against minimum resale price maintenance, holding only that for that rule to be applicable, there must be "some agreement on price or price levels." *Id.* at 736. Thus, the Court's concern was not with the application of strict rules in the vertical context, but with the clear delineation of the scope of such rules, so that they do not extend beyond their proper bounds. *Id.* at 726-28.

The view that certain vertical agreements—those that offer no procompetitive benefits—should be treated harshly is also supported by the late Professor Areeda. *See* VIII PHILLIP E. AREEDA, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1625d (1989) [hereinafter AREEDA, ANTITRUST LAW]; *see also id.* ¶ 1604e2. In discussing *Business Electronics* and *Cernuto v. United Cabinet Corp.*, 595 F.2d 164 (3d Cir. 1979), an opinion on which the Second Circuit relied in the present case, Professor Areeda advocated a *per se* rule where the challenged agreement is a product of coercion. *See* AREEDA, ANTITRUST LAW ¶ 1625d, at 309 (advocating condemnation of restraint "without requiring proof of market power or effects" when "the sole—or, at least, overwhelming—motivation for the restraint is the manufacturer's surrender to a complaining dealer"). The rationale for harsh treatment in such a case, even when it involves only a dealer termination, is that when the manufacturer's participation in the agreement is coerced, there is no reason to think the agreement serves interbrand competition. *See id.* When the agreement goes beyond termination to

elimination from an entire market, the case for condemnation is even more clear.

B. An Agreement Between a Firm and Its Supplier or Dealer to Eliminate a Competing Supplier or Dealer from the Market Injures Both Intrabrand Competition and Interbrand Competition.

1. *A Firm that Goes Beyond Terminating Its Relationship with a Supplier or Dealer and Seeks to Eliminate the Supplier or Dealer from the Entire Market Injures Both Intrabrand Competition and Interbrand Competition.*

A firm might reasonably choose to terminate a relationship with its supplier or dealer. Such a termination can be procompetitive because the supplier or dealer might no longer fit into the firm's manufacturing or marketing strategy, so that to continue the relationship might hinder the firm's efforts to compete. In these circumstances, the termination is vertical, in the sense in which it matters to be vertical in antitrust, because it can "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." *Sylvania*, 433 U.S. at 54.

But when a firm goes beyond terminating its relationship with a supplier or dealer, and seeks to eliminate that supplier or dealer from the entire market, it is no longer seeking to achieve efficiencies in the distribution of its product. Once the firm's relationship with the supplier or dealer is terminated, the firm can have no legitimate interest in the supplier's or

dealer's continued presence in the market.[5] Therefore, any attempt by a firm to eliminate its former supplier or dealer from the entire market is likely to be intended not to advance procompetitive interests of its own, but to deny its competitors access to the eliminated supplier or dealer.[6] Elimination for that reason is anticompetitive, in that it would not only injure intrabrand competition (between suppliers or dealers) but also interbrand competition (between firms that use those suppliers or dealers).

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[5] Actually, one can imagine a circumstance in which a firm might have a procompetitive reason to eliminate a dealer—though not a supplier like Discon. Specifically, a firm might want to eliminate a terminated dealer from the market so that the dealer does not serve as an avenue for the evasion of vertical nonprice restraints that the manufacturer imposes on its remaining dealers. *Cf. United States v. General Motors Corp.*, 384 U.S. 127 (1966). But because these circumstances "are not sufficiently common or important to justify the time and expense necessary to identify them," *Sylvania*, 433 U.S. at 50 n.16, it seems that even for them *per se* condemnation might be appropriate. In any event, a more procompetitive approach than eliminating the terminated dealer from the market would be to enforce the vertical restraints more strictly, leaving the dealer to sell the goods of competing suppliers; for that reason, elimination of the dealer would likely not survive the rule of reason. *See* I ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 69 (4th ed. 1997) ("If the procompetitive effects can readily be achieved by alternative means that create substantially smaller anticompetitive effects, the justification will be rejected.") (footnote omitted).

[6] Of course, the firm also denies itself access to the eliminated supplier or dealer. But the firm could still benefit from the elimination if, for example, it had an established relationship with the remaining supplier or dealer, as NYNEX did with AT&T Technologies here, or if it were better able than its competitors to provide its own supply or distribution needs, *see* Amended Complaint ¶ 27, J.A. 83 (noting that telephone companies sometimes perform their own removal services).

In this case, however, it seems unlikely that NYNEX, which faced little competition in the local telephone services market, Amended Complaint ¶ 23, J.A. 81, would have sought to eliminate Discon so as to gain an advantage over its limited competition, and the complaint makes no such allegation. Therefore, it seems unlikely that the purpose of the agreement alleged here was to injure interbrand competitors of NYNEX. That is especially so in that, because it was a monopolist, NYNEX could probably have eliminated Discon through unilateral conduct if such a result had been in NYNEX's economic self-interest.

2. *A Firm that Acquiesces in an Agreement with a Supplier or Dealer to Eliminate Another Supplier or Dealer from the Entire Market Injures Both Intrabrand Competition and Interbrand Competition.*

AT&T Technologies, however, had an obvious interest in eliminating competition from Discon. A terminated supplier's or dealer's competitors will always have an interest in seeing the terminated supplier or dealer eliminated from the market, because it is always possible that a firm that terminates its relationship with a supplier or dealer will, as a result either of a change in the firm's distribution plan or of a change in the terminated supplier's or dealer's willingness to conform to that plan, reinstate the terminated supplier or dealer. From the point of view of the supplier's or dealer's competitors, the only way to prevent this sort of reinstatement is to ensure that the terminated supplier or dealer no longer exists.

It was therefore in the interest of AT&T Technologies to seek NYNEX's assistance in eliminating Discon from the

market. For the reasons discussed above, it is unlikely that in this case NYNEX would have believed such elimination to be in its interest, and it might not even have been indifferent to it. Nevertheless, NYNEX might have gone along with such a plan if forced to do so by AT&T Technologies. Coercion is exactly the circumstance in which Professor Areeda says that close antitrust scrutiny is justified. *See* AREEDA, ANTITRUST LAW ¶ 1625d (discussed above). If NYNEX was coerced, the alleged agreement to eliminate Discon was intended to serve only AT&T Technologies's intrabrand interests, not NYNEX's interbrand ones. *Cf. Business Electronics*, 485 U.S. at 727 n.2 (recognizing that a firm might be coerced by a dealer—or, analogously, a supplier—to enter into an anticompetitive agreement, but that such coercion must be proved).

The absence of interbrand benefit is critical because, as *Sylvania* said, the promotion of interbrand competition is "implicit in every decision sustaining vertical restrictions under the rule of reason." 433 U.S. at 54. On remand of *Sylvania*, the plaintiff, Continental T.V., Inc., in fact argued that interbrand competition was harmed by the location restriction at issue in that case because "it was unable to enter the Sacramento market." 694 F.2d 1132, 1138 (9th Cir. 1982). That is, the plaintiff argued that Sylvania's restraint eliminated it entirely from the Sacramento market. The Ninth Circuit rightly rejected that argument, observing that the location clause "did not prohibit Continental from selling another manufacturer's television sets in Sacramento." *Id.* Suppose counterfactually, however, that after Continental attempted to enter the Sacramento market, it had been

required by Sylvania not only to conform to the terms of its location restriction but also to sell Sylvania products exclusively, and that this new exclusivity requirement for Continental had been motivated entirely by coercion of Sylvania by a powerful Sacramento retailer that sought to avoid competition with Continental.[7] In that hypothetical case, the agreement between Sylvania and the coercive Sacramento retailer would have been an agreement to eliminate Continental from the entire Sacramento market, and the agreement would have injured both intrabrand and interbrand competition. In those circumstances, the antitrust analysis of Sylvania's conduct would likely have reached a different result.

3. *An Agreement Between a Firm and Its Supplier or Dealer to Eliminate Another Supplier or Dealer from the Entire Market, Even If Not Directed at Competition in the Usual Antitrust Sense, Can Injure Both Intrabrand Competition and Interbrand Competition.*

The original complaint in this case alleged that the attempt to eliminate Discon was intended to facilitate regulatory fraud. Complaint ¶ 55, J.A. 16. *See also* Amended Complaint ¶¶ 33(b), 59, 61, J.A. 85, 92, 93 (describing fraudulent scheme under which NYNEX would use higher-cost supplier AT&T Technologies, passing on costs to NYNEX customers, and would receive year-end rebate from AT&T Technolo-

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[7] One must also suppose that the retail television market was characterized by significant product differentiation, so that vigorous interbrand competition would not have checked any effort to exploit reduced intrabrand rivalry. In the present case, of course, NYNEX was not faced with significant interbrand competition.

gies). Although the amended complaint contains no reference to the agreement's facilitation of the fraud, as the district court noted, App. to Pet. for Cert. 31a, Professors Areeda and Hovenkamp nevertheless say that this case is one of fraud, not antitrust. PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1644'c (1997 Supp.). They treat the case as one of fraud because they say the conduct involved presented no danger of monopoly. *Id.*

That is a reasonable interpretation of the case if one takes the view, as Areeda and Hovenkamp do, that the elimination of Discon was the "consequence" of the fraud, *id.*; however, Discon alleges an agreement to eliminate it from the market, not an agreement directed at some other purpose that as a consequence eliminated it from the market. If Discon has made this allegation satisfactorily, *see supra* part I, the case is not one of fraud.[8] If Discon has *not* made this allegation satisfactorily, it may be that Areeda and Hovenkamp's interpretation of the case is correct. Or it may be, as the government has argued, *see* Brief for the United States and the Federal Trade Commission on Petition for Certiorari at 7-9, that an agreement to facilitate regulatory fraud is an antitrust violation. We take no position on this question; we note only that if parties agree to eliminate a competitor in order to

[8] In that case, the regulatory fraud might have been the means by which NYNEX was induced to enter the alleged anticompetitive agreement, not the end sought by that agreement. That is, it might have been the willingness of AT&T Technologies to engage in the regulatory fraud that gave it the power to force NYNEX to go along with the elimination of Discon alleged in the complaint. *See* Brief for the United States and the Federal Trade Commission on Petition for Certiorari at 10 & n.9 (suggesting similar explanation for acquiescence of NYNEX).

facilitate fraud, and if they in fact succeed in eliminating the competitor, the necessary effect of their agreement will be to eliminate competition. *See* Brief for the United States and the Federal Trade Commission on Petition for Certiorari at 9-11.

III. THIS COURT HAS APPLIED *PER SE* TREATMENT TO CASES INVOLVING AGREEMENTS TO ELIMINATE COMPETITORS AND COERCED AGREEMENTS TO TERMINATE COMPETITORS, WITHOUT RELYING ON THE PRESENCE OF HORIZONTAL AGREEMENTS.

This Court has on at least two occasions held defendants subject to § 1 liability on *per se* theories in cases in which those defendants entered into no agreements with other firms at their levels. *See Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *United States v. General Motors Corp.*, 384 U.S. 127 (1966). Although each of these cases also involved a horizontal agreement at another level from the primary defendant, the Court did not indicate in either case that the horizontal agreement was necessary to its decision. *See Klor's*, 359 U.S. at 213 (describing the case as alleging "a wide combination consisting of manufacturers, distributors and a retailer"); *General Motors*, 384 U.S. at 145 ("Elimination, by joint collaborative action, of discounters from access to the market is a *per se* violation of the [Sherman] Act.").

Moreover, an explanation for the *per se* treatment in *Klor's* is that the primary defendant in that case, Broadway-Hale, despite being party only to vertical agreements, sought to eliminate a competitor. *See* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 332 (1978) ("If [*Klor's*] is to find justification in antitrust terms, it must be because the boycott contained, so far as we can tell, no

possibility of efficiency and did deprive consumers of an outlet they had shown they wanted.").[9] Broadway-Hale, an appliance dealer, agreed with appliance manufacturers that the manufacturers would cease selling appliances to Klor's, a competing dealer. This Court said that Broadway-Hale "used its 'monopolistic' buying power to bring about this situation," 359 U.S. at 209, and indicated that it was the elimination of Klor's that was the goal of the vertical agreements, *see id.* at 213 (rejecting the defense that Klor's was "so small that his destruction makes little difference to the economy" and stating that "[m]onopoly can as surely thrive by the elimination of such small businessmen, one at a time, as it can by driving them out in large groups"). In that respect, *Klor's* was like *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951), in

[9] *General Motors* is better viewed as a case only of termination, though termination that was the result of coercion. In *General Motors*, a group of General Motors dealers sought to eliminate "discount houses" from the market for selling General Motors cars. To accomplish this goal, the dealers joined together and sought action from General Motors itself. Although it is somewhat unclear whether General Motors itself preferred the elimination of the discount houses, *see* 384 U.S. at 137 (describing General Motors as "collaborat[ing] with these policing activities"), it seems that it would have had no independent incentive to eliminate them. Moreover, the Court suggested that the dealers acted collectively to enlist General Motors's collaboration. *See id.* at 143 ("Neither individual dealers nor the associations acted independently or separately."). Consequently, General Motors appears to have been held liable on a *per se* theory despite the fact that it was not a willing party to the horizontal agreement, but a coerced party to a vertical one. *See* AREEDA, ANTITRUST LAW ¶ 1604g3, at 70 n.133 (observing that *General Motors* is "noteworthy in imposing liability on the assumedly coerced and thus already-victimized manufacturer"). In that case, the horizontal agreement among the dealers provides the evidence of coercion that Professor Areeda says justifies *per se* treatment. *See* AREEDA, ANTITRUST LAW ¶ 1625d (discussed above).

which a firm also entered into vertical agreements in an attempt to eliminate a competitor. In both cases, the Court had no trouble finding the defendants liable.

To be sure, the Court in *Klor's* also said that the manufacturers conspired "among themselves." 359 U.S. at 209. But the agreement among the manufacturers was not treated by the Court as the source of the anticompetitive effects in the case; indeed, that would have been inconsistent with the Court's reference to Broadway-Hale's "monopolistic buying power." In fact, it appears that the agreement among the manufacturers was not an independent effort at collusion, but was subsidiary to Broadway-Hale's exercise of its power. It may be, for example, that Broadway-Hale's orchestration of an agreement among the manufacturers made them more willing to comply with Broadway-Hale's demands (because they would not thereby lose an outlet that their competitors would continue to have). And Broadway-Hale's enlistment of multiple manufacturers in its plan is evidence that the plan was not intended to advance interbrand competition among the manufacturers, but to eliminate Klor's.

IV. AN ANTITRUST RULE THAT APPLIED HARSHER TREATMENT TO AGREEMENTS TO ELIMINATE COMPETITORS THAN IS APPLIED TO AGREEMENTS TO TERMINATE BUSINESS RELATIONSHIPS WOULD BENEFIT ANTITRUST ANALYSIS.

Because an agreement to eliminate a competitor injures intrabrand competition without benefitting interbrand competition, it should be judged more harshly than a simple supplier or dealer termination. Either of two legal rules might be appropriate. One would be a *per se* rule, which Professor

Areeda has said is appropriate in cases where the challenged agreement is the product of coercion. Although "the scope of *per se* illegality should be narrow in the context of vertical restraints," *Business Electronics*, 485 U.S. at 724, it is not inconsistent with that principle to apply a *per se* rule to certain carefully delineated vertical restraints. So long as the range of applicability of the *per se* rule is clearly and carefully defined, there is little danger that it will be mistakenly applied beyond its proper bounds.

Alternatively, the Court could mandate a more strict application of the rule of reason to vertical agreements to eliminate competitors. For example, given the absence of benefit to interbrand competition from such agreements, the Court might state that such agreements are presumptively illegal. That is, proof of an agreement to eliminate a competitor could be sufficient to establish a violation of Sherman Act § 1, under the rule of reason, unless the defendant could show that the agreement had procompetitive benefits.

The court of appeals below advocated a similar approach, saying that although "*per se*" treatment might be appropriate, App. to Pet. for Cert. 13a n.6, NYNEX would be permitted on remand to offer procompetitive justifications for its actions. *Id.* at 12a-13a; *see also* Brief for the United States and the Federal Trade Commission on Petition for Certiorari at 16-17 (supporting court of appeals's approach). This approach would be consistent with the "quick look" rule of reason adopted for horizontal restraints among joint venturers in *N.C.A.A. v. Board of Regents*, 468 U.S. 85 (1984).

If either of these rules is to be applied to agreements to eliminate competitors, it is critical that such agreements be distinguishable from agreements to terminate business

relationships, which would continue to be assessed under the rule of reason, with the burden on the plaintiff to prove anticompetitive effects. The essential difference is that an agreement between a firm and its supplier or dealer to eliminate another supplier or dealer goes beyond the relationship between the firm and the favored supplier or dealer to make it more difficult for the supplier or dealer whose elimination is sought to deal with other market participants. For example, an agreement to eliminate a competitor might involve efforts to injure directly the relationships of the disfavored supplier or dealer with other market participants. *Cf. supra* note 2.[10] Or it might involve enforcement of a contract between one of the conspiring firms and the disfavored supplier or dealer that provides no benefit to the conspiring firm but disadvantages the supplier or dealer. *Cf. Serfecz v. Jewel Food Stores*, 67 F.3d 591, 594 (7th Cir. 1995) (allegation by shopping mall, Grove Mall, that food

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[10] It is important to emphasize that these acts must be in furtherance of an agreement to eliminate the competitor from the entire market. There are many cases in which references are made to defendants' attempts to "eliminate" competitors from the market, but where the facts go no further than to show attempts to take away the competitors' customers. For example, in one leading case, *Northwest Power Products, Inc. v. Omark Industries, Inc.*, 576 F.2d 83 (5th Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979), the court refers at one point to the efforts of the defendants, a manufacturer and its new distributor, "[t]o eliminate [a terminated distributor] from the market," *id.* at 86, but the facts appear to reflect only efforts, albeit unethical ones, by the defendants to shift the terminated distributor's customers to the new distributor. *See id.* at 85 (characterizing plaintiff as alleging that defendants conspired "to deprive it of its customers by tortious and unfair means"), 91 (noting that though the plaintiff's market share had decreased, it continued to compete with the new distributor).

store and new mall to which food store had moved "conspired to run Grove Mall out of business" by maintaining lease on now-empty anchor location in Grove Mall), *cert. denied*, 516 U.S. 1159 (1996); *supra* pages 12-13 (discussing hypothetical involving location and exclusivity restraints instituted to prevent dealer's entry into new market).

The task of distinguishing agreements to eliminate competitors from agreements to terminate distributors is one that the lower courts are well qualified to perform. Indeed, the rationale for the usual application of a rule of reason lies in the assumption that courts can distinguish factual circumstances that present anticompetitive dangers from those that do not. Application of a more strict rule in certain circumstances does not make this task of characterization more difficult; instead, it makes the task easier, by setting out specific criteria for its performance.

* * *

The rule of reason applicable to most antitrust challenges to business practices places a difficult burden on the plaintiff to establish, on a full record, the anticompetitive effect of the defendant's business practices. In light of the costs of litigation and the treble damages provided for in the Clayton Act, such a burden is justified for the majority of business practices that carry the potential to be procompetitive or at least competitively neutral. Since the early part of this century, however, this Court has recognized that this burden need not be borne by plaintiffs in those cases where the likelihood of competitive harm is sufficiently high to permit the courts to infer such harm from the nature of the business practice challenged. *See United States v. American Tobacco Co.*, 221 U.S. 106, 179 (1911) (rule of reason infers unreasonableness

of certain agreements because of their "inherent nature or effect" or "evident purpose"). Where a firm conspires with others to eliminate a rival from the entire market, the "evident purpose" of the restraint is sufficiently anticompetitive to permit the case to go forward, at least to the point of requiring the defendant to explain its actions, without initially requiring the plaintiff to present the detailed economic and factual record required by *Board of Trade of Chicago v. United States*, 246 U.S. 231 (1918).

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted,

MARK R. PATTERSON
Fordham University
School of Law
140 West 62nd Street
New York, New York 10023
(212) 636-7867

WARREN S. GRIMES
Southwestern University
School of Law

STEPHEN F. ROSS
University of Illinois
College of Law

APPENDIX

APPENDIX
LAW PROFESSORS JOINING THIS BRIEF*

Joseph F. Brodley
Boston University School of Law

Peter C. Carstensen
University of Wisconsin Law School

Harry First
New York University School of Law

John J. Flynn
University of Utah College of Law

Warren S. Grimes
Southwestern University School of Law

Robert H. Lande
University of Baltimore School of Law

Marina Lao
Seton Hall University School of Law

Mark R. Patterson
Fordham University School of Law

Stephen F. Ross
University of Illinois College of Law

Spencer Weber Waller
Brooklyn Law School

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* Institutional affiliations are provided for reference only.

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In the Supreme Court of the United States

OCTOBER TERM, 1997

NYNEX CORPORATION, ET AL., PETITIONERS

v.

DISCON, INCORPORATED, RESPONDENT

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF FOR THE AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION AS AMICUS CURIAE SUPPORTING PETITIONERS

PHILLIP D. BRADY
MARK SLYWYNSKY
American Automobile Manufacturers Association
1401 H Street, N.W.
Suite 900
Washington, D.C. 20005

STEPHEN M. SHAPIRO
ROY T. ENGLERT, JR.
Counsel of Record
DONALD M. FALK
MICHAEL E. LACKEY, JR.
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

Counsel for Amicus Curiae

HPP

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v.

DISCON, INCORPORATED, RESPONDENT

On Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

MOTION OF THE AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE SUPPORTING PETITIONERS

Pursuant to Sup. Ct. R. 37.3, the American Automobile Manufacturers Association ("AAMA") respectfully moves for leave to file the accompanying brief as *amicus curiae* in support of petitioner.[1] Petitioners have consented to the filing of the brief; counsel for respondent has consented orally to the filing of this brief, but AAMA had not received written consent by the time the brief was sent to be printed. See Sup. Ct. R. 37.3(a).

The American Automobile Manufacturers Association ("AAMA") is a non-profit national trade organization. Its member companies — General Motors Corporation, Ford Motor Company, and Chrysler Corporation — are the largest automobile manufacturers in the United States. The AAMA has often represented its members before this Court.

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[1] This brief was funded entirely by the AAMA and was authored entirely by its counsel.

The first question presented in this case provides two important and related opportunities to clarify the antitrust laws. First, this case calls for an evaluation of the vitality and proper scope of the *per se* prohibition of "group boycotts." Second, the Court can and should continue to clarify the status of vertical nonprice restraints.

The AAMA wishes to present its views on these issues because they are of exceptional significance to its members. Vertical restraints — agreements between firms at different levels of distribution — are important competitive tools for all manufacturers that face intense interbrand competition. Manufacturers use a variety of vertical agreements to obtain inputs with the greatest efficiency and at the lowest price. Vertical agreements are particularly important to manufacturers that, like AAMA members, distribute their products to the public through a network of independent local dealers.

The AAMA addresses these issues from the perspective of the domestic automobile industry to assist the Court in its assessment of the real-world consequences of the resolution of this case. The AAMA supports its views with examples from its members' experience competing in an industry marked by intense interbrand competition at the producer level. That experience has shown the importance of flexibility in commercial arrangements with parties at different levels of distribution. AAMA members can produce automobiles more efficiently if they are able to deal with sole-source or limited numbers of suppliers who have strong incentives to satisfy the standards of the industry. Similarly, manufacturers have promoted the efficient distribution of vehicles to consumers by imposing limits both on the number of authorized distributors and on their conduct. The possibility is remote that these vertical restraints could have any adverse effect on interbrand competition.

By contrast, hostility to such arrangements — whether it takes the form of the *per se* condemnation suggested by the Second Circuit in this case, or the condemnation after cursory

analysis that the government suggested in its *amicus* brief at the certiorari stage — threatens the efficiencies resulting from exclusive or limited supply and distribution agreements. Such arrangements should continue to be subject to full rule-of-reason review, with the accompanying presumption of legality.

For the foregoing reasons, the motion of the AAMA to file the accompanying brief as *amicus curiae* in support of petitioners should be granted.

Respectfully submitted.

PHILLIP D. BRADY
MARK SLYWYNSKY
American Automobile Manufacturers Association
1401 H Street, N.W.
Suite 900
Washington, D.C. 20005

STEPHEN M. SHAPIRO
ROY T. ENGLERT, JR.
Counsel of Record
DONALD M. FALK
MICHAEL E. LACKEY, JR.
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

Counsel for Amicus Curiae

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QUESTION PRESENTED

This brief addresses the first question presented:

Whether, by dealing with one supplier, a purchaser engages in a "group boycott" of the supplier's disappointed competitors, and thus may be subjected to *per se* liability under Section 1 of the Sherman Act.

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In the Supreme Court of the United States

OCTOBER TERM, 1997

No. 96-1570

NYNEX CORPORATION, ET AL., PETITIONERS

v.

DISCON, INCORPORATED, RESPONDENT

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF THE AMICUS CURIAE

The American Automobile Manufacturers Association ("AAMA") is a non-profit national trade organization. Its member companies — General Motors Corporation, Ford Motor Company, and Chrysler Corporation — are the largest automobile manufacturers in the United States. The interest of the AAMA is described in detail in the motion for leave to file this brief, *supra*.[1]

INTRODUCTION AND SUMMARY OF ARGUMENT

This Court has repeatedly narrowed the scope of business conduct that may be condemned *per se* under the antitrust laws — *i.e.*, condemned without proof of anticompetitive effects in a relevant product and geographic market, and without consideration of possible justifications. In particular, the Court has removed the *per se* stigma from all vertical *non*-price agreements that affect only a single manufacturer's

[1] This brief was funded entirely by the AAMA and was authored entirely by its counsel.

products, and even from vertical *price* agreements that set a maximum resale price for a single brand. Furthermore, the Court no longer condemns *per se* certain horizontal agreements that produce a common price. If the competitors who participate in the agreement are engaged in a legitimate, procompetitive joint venture, the Court recognizes that ancillary agreements on price may be lawful.

In the decision under review, the Second Circuit placed itself at cross-purposes with these trends toward greater flexibility for businesses engaged in efficiency-enhancing activities. The court transformed a garden-variety contractual relationship between two firms into a potential *per se* antitrust violation by mislabeling the contract a "group boycott" of a disappointed competitor.

An agreement by one firm to buy from another (and thus not from a third) may be an exclusive-dealing arrangement, but by no stretch of the imagination is it a "group boycott." The Second Circuit's error was in some ways understandable, however. This Court has not expressly disavowed some unfortunate language in two early boycott decisions: *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), and *United States* v. *General Motors Corp.*, 384 U.S. 127 (1966). *Klor's* and *General Motors* in large part have been superseded doctrinally by the more sophisticated analysis in later cases, but the two cases continue to add confusion to a very muddled area of law. It is important that the Court explicitly describe the current scope of the *per se* rule against group boycotts.

In *FTC* v. *Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 436 n.19 (1990), the Court suggested that *per se* treatment is now reserved for boycotts in the service of price-fixing agreements. If correct, that understanding should be made explicit in this case. In any event, the Court should make clear, *first*, that the *per se* rule against group boycotts covers only concerted refusals to deal with a supplier or customer by competitors of the victim of the boycott, and, *second*, that a concerted refusal to deal within a vertical

context (as among distributors of a single brand in a multi-brand market) is subject to rule-of-reason analysis just like other vertical nonprice restraints.

Full rule-of-reason analysis — not a "quick look" — should apply. The Court should reject the suggestion of the United States that the choice of one supplier rather than another might be condemned under a truncated rule of reason analysis when neither interbrand market power nor anticompetitive effects in a relevant market have been alleged or proved.

Finally, this Court should reaffirm that facially deficient antitrust claims can and should be dismissed for failure to state a claim. It is not appropriate for courts to develop novel, unpleaded and unbriefed legal theories in order to prolong antitrust lawsuits brought by disappointed competitors.

ARGUMENT

"[M]ost antitrust claims are analyzed under a 'rule of reason,' according to which the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition" under the circumstances of a particular case. *State Oil Co.* v. *Khan*, 118 S. Ct. 275, 279 (1997). This Court has found very few business practices to have "such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit," that they may be condemned *per se*; such treatment is justified only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Ibid.*

Despite the Court's recognition that *per se* condemnation is reserved for readily identifiable and pernicious practices, it remains settled law that there is a *per se* rule — of some sort — against "group boycotts." Yet the Court has recognized that "there is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the *per se* doctrine." *Northwest Wholesale Stationers* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284,

294 (1985) (quoting L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST § 83, at 229-230 (1977)). That confusion about the contours of the proscribed conduct makes *per se* treatment illogical and insupportable. When even courts cannot determine what a label means, to use that label after the fact to prohibit business conduct outright — magnifying the prohibition with the prospect of treble damages and potential criminal prosecution — leaves businesses in an impossible situation.

As the present case amply demonstrates, the confusion about boycott doctrine provides openings for companies to salve their wounds in the marketplace by claiming that the firms that would not buy from them in fact "boycotted" them. The Second Circuit's decision is an extreme example, inviting attempts to transform every market choice into a "boycott" of those not chosen. But such excesses are predictable in the absence of a clear definition of "group boycotts" from this Court.

Klor's and *General Motors* — two antiquated decisions in which this Court applied *per se* principles to concerted refusals to deal — are the cause of much of the confusion that this Court has decried. For that reason, "the benefits of providing guidance concerning the proper application of a legal standard" (*Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 230 (1993)) weigh heavily in favor of an explanation of the continuing precedential scope of those decisions.

I. VERTICAL ARRANGEMENTS INVOLVING A SINGLE MANUFACTURER OR CUSTOMER SHOULD NOT BE CONDEMNED *PER SE* AS "GROUP BOYCOTTS"

With good reason, this Court has exercised increasing caution in defining the types of business practices that may be condemned *per se* under the antitrust laws. In the context of business relationships, "easy labels do not always supply ready

answers." *BMI* v. *CBS*, 441 U.S. 1, 8 (1979). For that reason, the Court has repeatedly removed particular categories of conduct from the scope of any *per se* rule. *State Oil Co.* v. *Khan*, 118 S. Ct. 275 (1997) (maximum resale price maintenance); *Continental TV, Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (vertical territorial restrictions); *NCAA* v. *Board of Regents*, 468 U.S. 85 (1984) (price fixing by participants in joint venture); *BMI*, *supra* (same).

Consistent with that trend, the Court has held that the supposed *per se* condemnation of group boycotts does not reach all concerted refusals to deal. *Northwest Stationers*, 472 U.S. at 294. The Court has recognized that boycotts "are not a unitary phenomenon," *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531, 543 (1978), and that the question of which "boycotts" were *per se* violations and which were not has engendered "more confusion" than any other "aspect of *per se* doctrine." *Northwest Stationers*, 472 U.S. at 294. Such confusion — which shows that boycotts must be, and are in fact, evaluated one-by-one — cannot be reconciled with *per se* condemnation.

Because of this confusion, the Court has specifically warned that "the category of restraints classed as group boycotts is not to be expanded indiscriminately." *FTC* v. *Indiana Federation of Dentists*, 476 U.S. 447, 458 (1986). The Court has tried to limit "the *per se* approach * * * to cases in which firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor." *Ibid.*

More recently, the Court has suggested that group boycotts should be condemned *per se* only if they "involve[ ] * * * a horizontal price-fixing arrangement." *FTC* v. *Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 436 n.19 (1990). Because any "horizontal price-fixing arrangement" is independently subject to *per se* condemnation, the Court's explanation in *Trial Lawyers* indicates that there is no coherent

justification for retaining any independent *per se* rule against group boycotts.

The Second Circuit took an entirely different tack, and concluded that a single purchaser could run afoul of the *per se* rule against group boycotts by agreeing to do business exclusively with a single supplier. See Pet. App. 10a-13a & n.6. The Second Circuit misapplied one of this Court's least celebrated decisions, *Klor's*. The court of appeals believed that *Klor's* justified labeling an entirely *vertical* purchasing relationship between a single buyer and a single seller a "group boycott" of those not included in the transactions. That strange result underscores the need for this Court to clarify not only *Klor's* but also *General Motors*, the other leading case that addressed a "boycott" within a vertical distribution arrangement.

A. Two-Firm Vertical Agreements Are Not "Group Boycotts" Of Either Firm's Competitors

If the words "group boycott" are applied literally, the first question presented is easy: there is no such thing as a "group boycott" that includes only a vertical agreement between one buyer and one seller. Many courts understand this well enough: "[A] purely vertical arrangement, by which (for example) a supplier or dealer makes an agreement exclusively to supply or serve a manufacturer, is not a group boycott." *U.S. Healthcare, Inc.* v. *Healthsource, Inc.*, 986 F.2d 589, 594 (1st Cir. 1993) (Boudin, J.). See also Pet. App. 12a. In an early boycott case, this Court recognized that ending such contracts was presumptively lawful as well: a single buyer "has the unquestioned right to stop dealing with" a seller "for reasons sufficient to himself." *Eastern States Retail Lumber Dealers' Ass'n* v. *United States*, 234 U.S. 600, 614 (1914). See also *United States* v. *Colgate & Co.*, 250 U.S. 300, 307 (1919).

The Court more recently has defined the types of boycotts that concern the antitrust laws in plainer terms. Illegal boycotts involve refusals by multiple firms with market power to deal with their "suppliers or customers in order to discourage" the suppliers or customers "from doing business with a competitor" of the *boycotting* firm. *Indiana Dentists*, 476 U.S. at 458. That was the original understanding. See *Loewe* v. *Lawlor*, 208 U.S. 274, 294 (1908) (defining boycotts as "restraints of trade aimed at compelling third parties and strangers involuntarily not to engage in the course of trade except on conditions that the combination imposes"). And that conception is consistent with this Court's observation in *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764, 800-804 (1993), that a "boycott" must involve some collateral objective, not merely an effort to seek particular terms in particular transactions.[2] By contrast, in this case Discon alleged a simple bilateral exclusive-dealing arrangement between one supplier and its customer. NYNEX's choice of another supplier over Discon was not intended to induce Discon to do anything or to have any effect on competitors of NYNEX.[3]

Before coming to this Court, Justice Breyer observed that "courts have judged the lawfulness of contracts to purchase not under per se rules but under a 'rule of reason.'" *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 236 (1st Cir. 1983). No "vertical restraint is * * * illegal *per se* unless it includes some agreement on price or price levels" that might invoke the *per se* rule against *resale* price maintenance. *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 735-736 (1988). Indeed, this Court has explicitly

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[2] Indeed, one of this Court's earliest decisions under the Sherman Act *refused* to condemn an agreement by members of a livestock exchange not to deal with non-members, where no collateral objective was at issue. *Anderson* v. *United States*, 171 U.S. 604 (1898).

[3] Whatever it may be called, the refusal of a buyer (or of many buyers) to purchase from a particular seller is not a *boycott* unless the refusal is designed to achieve an anticompetitive end in the market at the *buyers'* level. See *Adaptive Power Solutions, LLC* v. *Hughes Missile Systems Co.*, ___ F.3d. ___, 1998 WL 172774, at *2-*3 (9th Cir. Apr. 15, 1998).

distinguished a two-firm vertical agreement from the "group boycotts" involved in *Klor's* and *General Motors*. See *id.* at 734. Like other vertical nonprice restraints, the alleged agreement that Discon challenged — a mere agreement by a buyer to purchase only from a particular seller — should be analyzed under the rule of reason. See *Continental TV, Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 57-59 (1977). Even if the purchase contract amounted to an "exclusive dealing arrangement[ ]," the rule of reason would apply. *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S., 2, 29-30 & n.51 (1984); *id.* at 44-45 (O'Connor, J., concurring) (citing *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 333-335 (1961)).

The Second Circuit expanded "the category of restraints classed as group boycotts * * * indiscriminately" (*Indiana Dentists*, 476 U.S. at 458) to encompass a two-firm vertical exclusive-purchasing contract. That seeming disregard for this Court's contrary instructions — and in particular the suggestion by the court of appeals that *per se* analysis could extend to such cases (see Pet. App. 11a & n.6) — invites antitrust litigation and threatens treble damages every time a buyer selects one seller over another. A disappointed dealer could characterize *every* exclusive distributorship and *every* requirements contract as a "group boycott" that the buyer and seller would be at pains to distinguish from the new category of *per se* offenses.[4] That result has no basis in current law.

B. The Rationale Of *Klor's* and *General Motors* Conflicts With Later Decisions Of This Court

Klor's and *General Motors* transplanted group boycott analysis — and *per se* condemnation — to essentially vertical arrangements that do not come within the boycott definition enunciated in *Indiana Dentists*. The reasoning of *Klor's* and

[4] The United States and the FTC agree that "a two-firm vertical restraint to exclude a supplier * * * cannot properly be termed a group boycott" because such a broad definition would encompass "[v]irtually any requirements contract." U.S./FTC Cert. Br. 14 & n.11.

General Motors is even more out of step with the Court's suggestion in *Trial Lawyers* that *per se* treatment is limited to refusals to deal which support price-fixing agreements. Although most of the reasoning in *Klor's* and *General Motors* has not survived this Court's modern antitrust jurisprudence, the two decisions have not been expressly overruled. Unsound statements in the two opinions remain available for misapplication by lower courts. Even if this case on its facts is not so close to either precedent to require reexamination of their actual holdings, the Court should expressly disapprove their flawed reasoning to forestall future misunderstandings.

1. In *Klor's*, the Court discerned (and condemned *per se*) a "group boycott" in a retailer's allegation that, at the urging of a single competing retailer located next door to the plaintiff, appliance manufacturers and their distributors had conspired to constrict the plaintiff's supply. 359 U.S. at 209. The plaintiff alleged that only one of its own competitors was involved in the conspiracy; the alleged horizontal conspiracies involved only firms that did not compete with the plaintiff. From all appearances, the manufacturers and distributors merely chose the plaintiff's competitor over the plaintiff as their only outlet on the block containing both stores; other retailers sold the same appliances within a few blocks. See *id.* at 209-210.

Nonetheless, the Court held that the alleged agreement came within a *per se* "forbidden category" of "[g]roup boycotts." 359 U.S. at 212. The Court disregarded as irrelevant the undisputed evidence that the arrangement lacked any marketwide anticompetitive effects. *Id.* at 209-210. The asserted reason that no showing of anticompetitive effects was needed, and that no showing of procompetitive effects could justify the action, was that the agreement "cripple[d] the freedom of traders and thereby restrain[ed] their ability to sell in accordance with their own judgment." *Id.* at 212 (quoting *Kiefer-Stewart Co.* v. *Joseph E. Seagram & Sons*, 340 U.S. 211, 213 (1951)). The Court went so far as to deny the manufacturers

and distributors the ability to exercise "their own judgment" to deal with one retailer rather than its neighbor. *Ibid.* Such actions "interfere[d]" with the Court's view of a wholly atomistic but supposedly "natural flow of interstate commerce" in which each actor is entitled to deal with others whether or not they want to deal with him. *Id.* at 213. That is, because the agreement harmed a single competitor, it violated the antitrust laws even if it did not harm competition generally.

2. Seven years later, the Court extended *Klor's* to reach the attempt of a manufacturer and its authorized dealers to maintain the integrity of the authorized distribution of a single brand in a competitive market. In *General Motors*, the manufacturer had created a typical distribution system with a limited number of dealers authorized to sell its vehicles to the public. The manufacturer kept limits on the configuration of its distribution system in part by including a "location clause" in the dealer agreement, which confined a dealer's privilege to sell the manufacturer's vehicles to locations approved in advance by the manufacturer. In return for this privilege (which was not territorially exclusive), the dealers were expected to contribute substantial capital investments and to provide warranty service; in addition, the manufacturer often invested capital directly in a dealership. See 384 U.S. at 144 n.19. A few authorized dealers attempted to circumvent the distribution system and encourage free-riding on the others' services by selling vehicles to unauthorized resellers for resale to the public, or by using unauthorized resellers as agents in additional unauthorized locations. The manufacturer, together with its dealer organizations, pressured the offending dealers to end this practice.

Going beyond *Klor's*, the Court held that these efforts to maintain the integrity of a single manufacturer's distribution system amounted to a *per se* violation of the antitrust laws. In the Court's view, *per se* prohibitions applied to any concerted action that "deprive[d] others of access to merchandise which the latter wish to sell to the public." 384 U.S. at 146. Without

elaboration, the Court repeatedly equated a single brand, Chevrolets, with "the market" (*id.* at 145, 146) and held that *any* "[e]xclusion of" one or more "traders from the market by means of combination or conspiracy" violated the Sherman Act (*id.* at 146). The Court's broad statements suggested that any attempt by a manufacturer to enforce restrictions on its distribution system through the cooperation of its dealers was illegal. In effect, the Court held that the desire of a manufacturer to control its "system for distributing automobiles" (*ibid.*) necessarily had to yield before the desire of a few dealers to evade that system by free-riding on the others.[5]

3. The Court in *Klor's* and *General Motors* interpreted the antitrust laws as a guarantee to particular competitors of complete freedom to structure their businesses however they liked. It since has become "axiomatic," however, "that the antitrust laws were passed for the protection of competition, not competitors." *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (internal quotation marks omitted). That axiom alone should demolish the Second Circuit's suggestion that the "group boycott" label (and *per se* treatment) might apply to any contract that "seeks to disadvantage the direct competitor[s]" of one of the contracting parties. Pet. App. 11a. All contracts necessarily disadvantage "direct competitor[s]" by giving the contracted-for business to one party and not to someone else. That factor has no place in reasoned antitrust analysis, much less as part of a *per se* inquiry.[6]

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[5] The Court also viewed the conduct in *General Motors* as resale price maintenance, though it addressed pricing only as an afterthought. See 384 U.S. at 147-148; see also *id.* at 148-149 (Harlan, J., concurring in the result). It is doubtful that the conduct in *General Motors* could be characterized as resale price maintenance after *Monsanto* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984), and *Business Electronics*.

[6] Unlike the essential concept of freedom *from legal restraints* on engaging in particular marketplace transactions, a generalized notion of "freedom" from any *contractual* restraints on future market behavior is not

The Court not only has eliminated the central rationale for *Klor's* and *General Motors* (and, thus, the decision below) but also has limited the sweeping condemnation of refusals to deal in two ways. First, the Court has removed all vertical nonprice restraints from the scope of the *per se* rule. Second, the Court has repeatedly narrowed the scope of conduct that falls within the *per se* prohibition of "group boycotts."

This Court in most respects has abandoned its brief but unjustified hostility towards the ability of manufacturers to organize and restrict the distribution of their products. The Court now substitutes an inquiry into the "demonstrable economic effect" of a practice on *interbrand* competition for its earlier "formalistic line drawing." *Continental TV, Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 59 (1977). In *Sylvania*, the Court held that no *per se* rule prevented a single manufacturer from enforcing a system of location clauses almost identical to the one that was rendered unenforceable in *General Motors*. The Court had explicitly prohibited all territorial restrictions *per se* a year after deciding *General Motors*. See *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). The Court overruled *Schwinn* because the earlier decision had not "distinguish[ed] among the challenged restrictions on the basis of their individual potential for intrabrand harm or interbrand

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a meaningful antitrust criterion: all contracts restrict the latter "freedom." See *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 687-688 (1978). Rather than condemn particular practices based on vague notions of business "freedom," the Court has inquired whether they can be predicted with confidence to have negative consequences for consumer welfare, recognizing that "Congress designed the Sherman Act as a consumer welfare prescription." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 343 (1979) (internal quotation marks omitted). Although the Court has proceeded cautiously and applied its new focus to particular categories of restraints one by one, the Court's focus on consumer welfare has driven it inexorably toward agreement with former Assistant Attorney General Baxter's trenchant observation that "[a] vertical problem is either a horizontal problem in disguise or no problem at all." Quoted in Meadows, *Bold Departures in Antitrust*, FORTUNE, Oct. 5, 1981, at 180, 182.

benefit." 433 U.S. at 52. In the face of the "substantial scholarly and judicial authority support[ing] the[ ] economic utility" of single-brand vertical restrictions and the "relatively little authority to the contrary," the Court found it impossible to condemn such restrictions *per se*. *Id.* at 57-58.

Significantly, the Court in *Sylvania* rejected the view, central to both *Klor's* and *General Motors*, that vertical restraints should be *per se* illegal whenever they prevent any independent business from doing exactly what it wants. Cf. *Sylvania*, 433 U.S. at 66-69 (White, J., concurring). In addition, *Sylvania* indicated that the rule of reason governs the antitrust analysis of all vertical nonprice restraints (which include a variety of exclusive arrangements) and thereby made clear that the *per se* rule does not apply to every arrangement that could be characterized as a concerted refusal to deal.

4. More recently, the Court has observed that antitrust courts cannot justify applying a *per se* rule to any concerted refusal to deal simply by invoking the "group boycott" label. "[N]ot every cooperative activity involving a restraint or exclusion will share with *per se* forbidden boycotts the likelihood of predominantly anticompetitive consequences." *Northwest Stationers*, 472 U.S. at 295. Even a plaintiff alleging that a group of its horizontal competitors agreed to exclude it from some advantage "must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects." *Id.* at 298. Rule-of-reason analysis would apply, for example, to a buying cooperative's enforcement of restrictions on its membership unless the excluding members possessed "market power or exclusive access to an element essential to effective competition." *Id.* at 296. Thus, by requiring a case-by-case demonstration of the likelihood that each alleged "group boycott" would have anticompetitive effects, and by insisting on a threshold showing of market power, the Court squarely rejected the limitless *per se* rule outlined in *Klor's* and *General Motors*. See *Rothery Storage & Van Co.* v. *Atlas Van Lines, Inc.*, 792 F.2d 210,

215-216, 229 (D.C. Cir. 1986) (Bork, J., joined by Ruth Bader Ginsburg, J.).

In *Indiana Dentists*, the Court expressly disapproved the earlier practice of "forcing" a specific practice or "policy into the 'boycott' pigeonhole and invoking the *per se* rule." 476 U.S. at 458. As noted above, the Court limited the *per se* rule to "cases in which" multiple "firms with market power boycott suppliers or customers" (*i.e.*, firms at a different level of distribution) "in order to discourage them from doing business with a competitor" (*i.e.*, a firm at the same level as the boycotters). *Id.* at 458. Neither *Klor's* nor *General Motors* met those criteria.

5. The Court has "been solicitous to assure that the market-freeing effect of [the] decision in *GTE Sylvania* is not frustrated by related legal rules," including the prohibition of group boycotts. *Business Electronics*, 485 U.S. at 726. Where vertical relationships are involved, "there is a presumption in favor of a rule-of-reason standard," rebuttable only "by demonstrable economic effect * * * rather than formalistic distinctions." *Ibid.* That is because "*interbrand* competition is the primary concern of the antitrust laws." *Ibid.* (emphasis added). The Court has concluded that "a vertical restraint is not illegal *per se* unless it includes some agreement on price or price levels." *Id.* at 735-736. In addition, the Court has explicitly held that *Klor's* and *General Motors* did *not* render *per se* illegal an agreement between a manufacturer and a dealer to terminate another, price-cutting dealer. See *id.* at 734.

The vertical agreements in *Klor's* and *General Motors* did not include specific agreements on price levels. Rather, each case involved efforts by dealers to prompt manufacturers to discipline retailers who were free riding on other dealers' services.

The horizontal aspects of the agreements alleged in the two cases likewise do not imperil competition to the point of

warranting *per se* condemnation. The alleged agreements among manufacturers and distributors in *Klor's* had no discernible effect on price or output, but simply disadvantaged a single retailer who apparently offered lower prices than his full-service next-door neighbor. As Judge Easterbrook has observed, however, the "core question in antitrust is output. Unless a contract reduces output in some market, to the detriment of consumers, there is no antitrust problem." *Chicago Professional Sports Ltd. Partnership* v. *NBA*, 95 F.3d 593, 597 (7th Cir. 1996). Yet the Court in *Klor's* found entirely irrelevant the absence of effects on output or on interbrand competition — an absence of anticompetitive effects that resulted from the presence of many outlets carrying the various appliance brands within a few blocks of the plaintiff's and defendant's stores.

As for the single-brand limited distribution system at issue in *General Motors*, Judge Posner has explained that "[i]t is unrealistic to expect the manufacturer that uses location clauses and outlet restrictions in order to limit free riding to be indifferent to the dealer that circumvents the intent of the clauses by discounting." Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 12 (1981). And this Court has recognized that it is equally unrealistic to expect dealers who comply with the manufacturer's rules and are the victims of free riding to suffer their losses in silence. Rather, the dealers, either singly or through their trade associations, must be expected to bring free riders to the manufacturer's attention with the expectation of some response: "[C]omplaints, particularly where the manufacturer has imposed a costly set of nonprice restrictions, arise in the normal course of business and do not indicate illegal concerted action." *Monsanto* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 763 (1984) (internal quotation marks omitted); see also Posner, *supra*, 48 U. CHI. L. REV. at 13. Actions by participants within a single-brand distribution network that maintain the integrity of that network *promote* rather than dis-

courage *interbrand* competition. Treating those actions as suspect "horizontal" restraints creates "needless confusion" in antitrust law and deters procompetitive conduct. *Business Electronics*, 485 U.S. at 730.

6. *Klor's* and *General Motors* are relics of a bygone era. Both decisions proceeded from the premise that manufacturers could not restrict a single retailer from selling the products he wanted in the way he wanted, and thus that they could not control the distribution of their own products even in ways that did not hurt interbrand competition. Indeed, *Klor's* relied explicitly (359 U.S. at 212) on *Kiefer-Stewart* for the proposition that even manufacturer-driven agreements that "lower prices or * * * stimulate competition" are flatly illegal if they "cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." But *Kiefer-Stewart* has been overruled in two separate respects: first, in *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752 (1984), the Court rejected *Kiefer-Stewart*'s holding that an agreement between a firm and its wholly owned subsidiary could amount to an illegal conspiracy; second, in *Khan*, the Court rejected *Kiefer-Stewart*'s holding that maximum resale price maintenance amounted to a *per se* violation of the Sherman Act despite its benefits to consumers. In both instances, the Court found it necessary to repudiate flawed reasoning that stemmed from unjustified hostility toward vertical restraints.

General Motors shares many of the defects of *Klor's*, but also prefigured the overruled decision in *Schwinn*. The overruling of *Schwinn* did not automatically bring down *General Motors* with it, because the distributors in *General Motors* actively protected their common interests in the preservation of the dealer system to which they agreed. But that fact does

not change the essentially vertical nature of the restraint at issue in that case.[7] See *Monsanto*, 465 U.S. at 763.

Klor's and *General Motors* now are significant principally as sources of confusion that support ill-reasoned condemnation of exclusive dealing arrangements. The Court should clarify that those cases no longer serve as valid authority beyond their particular facts, if indeed they survive to that extent.

C. This Court Should Make Clear That Nonprice Agreements Between A Supplier And Its Distributor Or Customer Are Presumptively Legal

"[T]he primary purpose of the antitrust laws is to protect interbrand competition." *Khan*, 118 S. Ct. at 282. Vertical restraints generally limit the number and conduct of distribution outlets for particular brands of products — the very conduct broadly condemned *per se* in *Klor's* and *General Motors*. Modern economic analysis confirms that such conduct ordinarily intensifies interbrand competition. R. BORK, THE ANTITRUST PARADOX 288-291 (2d ed. 1988); Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982); Posner, *supra*, 48 U. CHI. L. REV. at 11; Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960). That is because "[t]he manufacturer shares with the consumer the desire to have distribution done at the lowest possible cost consistent with effectiveness," BORK, *supra*, at 290; it has no incentive to restrict its dealers in a way that harms their customers. Accordingly, "vertical restraints are generally more defensible than horizontal restraints" because of "the possibility that a vertical restraint imposed by a single manufacturer or wholesaler may stimulate interbrand competition even as it reduces intrabrand competition." *Khan*, 118 S. Ct. at 281.

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[7] *General Motors* disregarded the location clause that provided the framework for the vertical organization of the distribution system, but no meaningful analysis of the consumer welfare effects of the challenged actions could disregard that vital fact.

The Court should make clear that vertical agreements between a supplier and its customer, or between a manufacturer and its distributors — whether purchase contracts, exclusive-dealing arrangements, or non-price or maximum-price restrictions on the distribution of a single manufacturer's products — should be evaluated under the rule of reason and are presumptively legal in the absence of demonstrable anti-competitive effects borne by consumers. Such clear statements are needed to prevent the use of creative characterization to "frustrate[]" the "market-freeing effect" of this Court's decisions upholding vertical nonprice restraints. *Business Electronics*, 485 U.S. at 726.

Adopting a rule of presumptive legality for vertical non-price agreements between a single manufacturer and its chosen suppliers or dealers would help ensure that legitimate procompetitive conduct is not deterred by the threat of treble-damage antitrust liability. The amorphous legal standards for the boycott rule increase that risk. See Baumol & Ordover, *Use of Antitrust to Subvert Competition*, 28 J.L. & ECON. 247, 254 (1985). In particular, "[v]ertical relations between a manufacturer and [its] dealers have been a subject of frequent litigation, often of doubtful merit." *Id.* at 263. The lack of clear guidance can lead to many years of contentious, expensive, and ultimately counterproductive litigation. See Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 23 (1984) (noting that *Sylvania* lasted more than a decade); see also, *e.g.*, *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977) (damages aspect of lawsuit terminated after 11 years because of this Court's unanimous determination that the lawsuit did not allege injury of the type the antitrust laws were designed to prevent).

A vertical nonprice agreement between a single supplier and its distributor, or a purchaser and its chosen sole supplier, poses no danger to competition. To the contrary, the virtues of such restraints have long been known. See *Sylvania*, 433 U.S. at 36. Indeed, there is substantial authority for the proposition that vertical restraints in general, and particularly exclusive or restricted distribution arrangements, should be presumptively legal, if not legal *per se*. As Judge Posner explained, "in no case * * * has a purely vertical restriction on competition been shown to be anticompetitive." Posner, *supra*, 48 U. CHI. L. REV. at 22. Rigorous analysis bears out this conclusion; Judge Easterbrook reported from his independent review that, "in every vertical case in which modern econometric methods have been used, the economists found that the practices expanded output." Easterbrook, *supra*, 63 TEX. L. REV. at 32. Judge Bork put the issue in a nutshell: "[A]ll vertical restraints are beneficial to consumers and should for that reason be completely lawful." BORK, *supra*, at 297. Other commentators agree. Marvel, *supra*, 25 J.L. & ECON. at 25 ("exclusive dealing ought * * * to be treated as legal, per se"); Posner, *supra*, 48 U. CHI. L. REV. at 6; Baxter, *The Viability of Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 947 (1987) ("all vertical arrangements should be presumed benign"); Bock, *An Economist Appraises Vertical Restraints*, 30 ANTITRUST BULL. 117, 138-140 (1985) ("vertical arrangements should be viewed as competitive" in the absence of supplier monopoly or cartel).

Purely vertical restrictions are unlikely to harm consumers: a manufacturer "gains nothing by reducing competition in the distribution of its product, though it may gain from redirecting that competition from price to service." Posner, *supra*, 48 U. CHI. L. REV. at 6. Likewise, a company that chooses to buy its supplies of a particular input from one supplier rather than many will invariably do so because it perceives that doing so will serve its own best interests. Those interests are closely aligned with — not antithetical to — the consumer's interest in the production of high-quality goods or services at the lowest feasible cost.

Indeed, this Court has recognized that nonprice vertical restraints pose limited risks of anticompetitive effects. In particular, there is no evidence that vertical nonprice restraints

have a cartel-facilitating effect. *Business Electronics*, 485 U.S. at 726. "Given the absence of either theoretical or empirical grounds for condemning purely vertical restrictions as anti-competitive, to declare vertical nonprice restrictions presumptively legal * * * would serve both to lighten the burden on the courts and to lift a cloud of debilitating doubt from practices that are usually and perhaps always procompetitive." Posner, *supra*, 48 U. CHI. L. REV. at 23.

This Court should reject all attempts to place on essentially vertical, *intra*brand or single-customer arrangements labels and penalties that are appropriate only for conduct that is horizontal in an *inter*brand sense. The rule of reason, weighted by a presumption of legality, should govern all agreements that are vertical in substance as well as those that are vertical in form.

D. Conduct Undertaken Within The Supply And Distribution Arrangements Of A Single Manufacturer Should Be Analyzed Under The Full Rule Of Reason, Not A Truncated And Hostile Mode of Analysis

In its *amicus* brief at the petition stage, the United States and the FTC suggested that the single exclusive dealing relationship here, if not subject to *per se* condemnation, nonetheless might be condemned after only a cursory "quick look" at any justifications advanced for it. U.S./FTC Cert. Br. 16-17 (citing *Indiana Dentists* and *NCAA* v. *Board of Regents*, 468 U.S. 85 (1984)). Such a truncated approach would penalize procompetitive business practices and is no more defensible than the Second Circuit's expansion of the *per se* rule.

The Court should emphatically reject the government's invitation to expand the domain of "quick look" analysis, which usually equates to condemnation after a "quick look," to vertical restraints. Whatever the merits of the "quick look" approach when applied to horizontal restraints, there is no call to revive the discredited tradition of judicial hostility to ver-

tical restraints, which was founded on mistrust of business conduct that may harm individual competitors but that does not harm competition as a whole.

Application of a truncated rule-of-reason analysis to the contract at issue here necessarily would reflect a judgment that such vertical arrangements nearly always are anticompetitive, so that only the most obviously procompetitive exceptions can be tolerated. But, unlike the horizontal output restrictions addressed in this Court's cases applying a "quick look" rule-of-reason analysis, the vertical supply agreement here — and the single-brand distribution arrangements challenged in *General Motors* and other cases involving the automobile industry — do *not* predictably have pernicious effects. To the contrary, exclusive supply arrangements, like exclusive or limited distribution arrangements, normally provide procompetitive benefits through decreased input prices and increased distribution services.

Neither the government nor the Second Circuit has advanced any reason why the antitrust laws should force NYNEX to divide its scrap removal business among several contractors, much less why those laws should force it to choose Discon over Discon's competitors. In the absence of any plausible and coherent allegation that the choice of one scrap remover over another had a significant and demonstrable anticompetitive effect in a relevant market, there is no sound reason for an antitrust court to second-guess NYNEX's determination of which entity can best salvage its scrap telephone lines and equipment. See *Monsanto*, 465 U.S. at 761; *Colgate*, 250 U.S. at 307.

Discon did not allege any anticompetitive effect in a facially plausible relevant market. The removal of NYNEX's scrap may be the single-customer niche that Discon wanted to serve, but to label that niche a "market" would be frivolous. Indeed, the complaint makes clear that most other telephone companies in NYNEX's position "rel[ied] on unaffiliated contractors for removals" or used their own employees (J.A. 83).

NYNEX's purchasing practices could have had no effect on competition for removal of telephone equipment generally even if that service were somehow distinct from other salvage services.

That Discon was hurt — even if NYNEX "wanted" to hurt Discon — makes no difference. Without an injury to competition in a relevant market, Discon's misfortunes and NYNEX's alleged misconduct are of no concern under the Sherman Act. See P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 1644c, at 726-728 (Supp. 1997) (discussing decision below). See also *Brooke Group*, 509 U.S. at 225. They certainly do not justify a regime of judicial hostility toward single-buyer exclusive supply contracts under either a *per se* or a "quick look" approach.

II. UNCERTAINTY ABOUT "GROUP BOYCOTTS" IMPEDES PROCOMPETITIVE CONDUCT IN THE AUTOMOBILE INDUSTRY

Automobile manufacturers, like many other businesses, do not deal with everyone who offers materials or who wishes to sell newly manufactured vehicles. To the contrary, automobile manufacturers have realized far greater efficiencies by purchasing in greater volumes from a limited number of authorized parts suppliers, and in selling new vehicles through a coordinated network of a limited number of authorized dealers. "Most economists recognize that * * * much private litigation surrounding the[ ] use [of vertical restraints] involves contract disputes rather than antitrust problems." Klein & Murphy, *Vertical Restraints As Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 295 (1988). If this Court does not clarify the confusion about group boycotts that led to the decision below, such misuses of the antitrust laws to hamper efficiency will only increase in frequency.

A. The Continuing Confusion Surrounding "Group Boycotts" Impedes The Ability Of Automobile Manufacturers To Preserve The Quality And Integrity Of Their Dealership Networks

New automobiles are sold in the United States almost exclusively through networks of independent, franchised local dealers. All manufacturers limit the number of dealers who have the right to sell each manufacturer's new vehicles; most dealers compete with other authorized dealers for the same make within a given geographic area.

Manufacturers require their dealers to invest substantial capital to acquire and maintain their authorized dealerships. Because of the expensive services manufacturers typically require their dealers to provide, the automotive industry is often cited as a classic example of an industry in which free riding can pose a substantial problem. *E.g.*, *Sylvania*, 433 U.S. at 55; Kelly, *The Role of the Free Rider in Resale Price Maintenance, the Loch Ness Monster of Antitrust Captured*, 10 GEO. MASON U. L. REV. 327, 361 (1988).

Dealers must expend substantial sums to purchase, staff, and equip their showrooms. The facility must be sufficiently spacious and well lit to display the vehicles in an attractive fashion. Modern showrooms also contain audiovisual displays to provide consumers with in-depth information about specific models. Manufacturers require dealers to maintain an adequate vehicle inventory, with an appropriately broad range of models and colors. And dealers are responsible for hiring and keeping a sufficient number of knowledgeable salespeople, who often are required to attend manufacturer-designed courses to learn about the various models. The sales staff may need follow-up and refresher training each new model year.

In addition, dealers generally must make substantial investments in advertising and promotional activities, including community sponsorships, that are designed to generate good will and to inform the public regarding the availability

and attributes of the manufacturer's automobiles. Among the extensive post-sale services that dealers provide are a service department and parts inventory to handle warranty repairs and maintenance, and to keep replacement parts available to vehicle purchasers and independent mechanics. Manufacturers often require that parts and service departments meet specific standards in tools and equipment, and maintain a staff with appropriate technical certification and training.

Manufacturers cannot effectively compete in the nationwide, interbrand automobile market without a widespread network of dealers offering high-quality services. By characterizing as a "group boycott" a simple choice of one vertical business relationship over another, the decision below would place a powerful constraint on a manufacturer's ability to ensure that its dealers provide the services that customers typically demand. Maintaining that level of services may require the manufacturer to limit the number of outlets in a particular area, despite the eagerness of a prospective dealer to carry the manufacturer's brand. Manufacturers need to be able to use "vertical restraints ancillary to exclusive [or partly exclusive] dealing," such as "[c]ooperative advertising, warranty registration, and repair restrictions[,] * * * in order to charge dealers more efficiently for manufacturer promotional efforts." Marvel, *supra*, 25 J.L. & ECON. at 10.

To attract and retain well-financed and service-intensive dealers, a manufacturer may have to prevent some dealers from free riding on their peers' services. Free-riding dealers may offer the lower vehicle prices that substandard service costs would permit, or may increase their own volume by selling at wholesale to brokers or other non-dealers who free ride on the services of other dealers. Under the rules advanced by the Second Circuit and the government, however, a manufacturer that took any action against free-riders to preserve the integrity of the dealer network would expose itself to an antitrust lawsuit on the theory that it and one or more authorized dealers engaged in a group boycott against the prospective dealer or the free rider.

Litigation of a type that flourished before *Sylvania* and *Sharp* — and still is not unusual — could flourish anew using the "group boycott" label to attack the manufacturer's freedom to market its products as it sees fit, with or without prompting from its current dealers. Disgruntled dealers and dealer-applicants have not hesitated to enlist the antitrust laws in attempts to override manufacturers' choices — all of which might be forced into the "boycott" category if the Second Circuit's decision were affirmed. See, *e.g.*, *Lovett* v. *General Motors Corp.*, 998 F.2d 575 (8th Cir. 1993), cert. denied, 510 U.S. 1113 (1994); *Arnold Pontiac-GMC, Inc.* v. *General Motors Corp.*, 786 F.2d 564 (3d Cir. 1986); *Parsons* v. *Ford Motor Co.*, 669 F.2d 308 (5th Cir.), cert. denied, 459 U.S. 832 (1982); *Quality Mercury, Inc.* v. *Ford Motor Co.*, 542 F.2d 466 (8th Cir. 1976), cert. denied, 433 U.S. 914 (1977); *Tunis Bros. Co.* v. *Ford Motor Co.*, 696 F. Supp. 1056 (E.D. Pa. 1988) (denying Ford's motion for summary judgment on group boycott claim because of confused legal standard under both *per se* rule and rule of reason), later decision, 952 F.2d 715 (3d Cir. 1991), cert. denied, 505 U.S. 1221 (1992).

In substance, these lawsuits are either breach-of-contract claims or simple efforts to force a manufacturer to alter its distribution system for the benefit of the plaintiff. To forestall these misuses of the antitrust laws, this Court should make clear that, so long as interbrand competition is robust, all vertical nonprice agreements between a manufacturer and its dealers are presumptively legal.

B. The Confusion Surrounding "Group Boycotts" Impedes The Ability Of Automobile Manufacturers To Contract Efficiently With Suppliers

Automobile manufacturers depend on close, mutually advantageous relationships with their parts suppliers. The automotive industry uses hundreds of thousands of parts made by

tens of thousands of approved suppliers. Many of these parts are made to precise specifications, with tolerances as close as a few thousandths of an inch. Manufacturers thus cannot, by and large, buy component parts off the shelf, but rather must have parts made to the specifications for a particular vehicle. To provide incentives for high standards of compliance, and to allow suppliers to take advantage of efficiencies of scale that result in lower part prices, automobile manufacturers routinely enter into exclusive or partially exclusive sole- or second-source arrangements for the supply of particular parts. It is a matter of great concern to the industry if a manufacturer that terminates one supplier in favor of another may face treble-damages "group boycott" litigation in addition to a contract dispute.

Automobile manufacturers also impose demanding delivery requirements. Many major manufacturers now use a "just-in-time" system, in which parts must arrive at the factory just before vehicles are assembled. "Just-in-time" systems produce substantial savings through reduced parts inventories and fewer assembly line delays. But to run this type of supply system requires close computer coordination between the manufacturer and its suppliers. In many cases, the computers of suppliers and manufacturers are linked so that design and shipping data can be electronically communicated.

Because the design and supply of parts now depends so substantially on the interaction of computer systems, automobile manufacturers have taken action to prevent any disruptions in automobile production by the "Year 2000 problem," which may immobilize some computers in less than two years. Many of the manufacturers' efforts come within the framework of the Automotive Industry Action Group ("AIAG"), a non-profit trade association of vehicle manufacturers and their suppliers that encourages technological improvements to increase efficiency in production. Among other projects, the AIAG has provided self-assessment surveys to more than 65,000 suppliers to ascertain whether they have

developed workable plans to respond to the Year 2000 problem. Some manufacturers are conducting follow-up audits to obtain a first-hand look at the scope of the problem, which is complicated further by the fact that many first-tier suppliers purchase their own materials and parts from second-tier firms on whose computer systems the first-tier suppliers depend.

The AIAG collects and appraises suppliers' survey responses, evaluating them in light of certain quantitative standards for remedial activity. The AIAG then classifies suppliers by the degree of risk the Year 2000 problem presents to their ability to maintain continuity of supply, identifying as "high risk" those suppliers that are least prepared to respond to the Year 2000 problem. Although the AIAG is collectively gathering data from the *suppliers*, each manufacturer *separately* determines whether its suppliers are taking sufficient steps to ensure that their computer systems will be sufficiently reliable to ensure continuing compliance with the tight manufacturing tolerances and just-in-time delivery schedules demanded by modern automotive manufacturing.

In the near future, a manufacturer quite possibly may determine, based in part on data collected by AIAG, that a supplier's response to the Year 2000 problem was inadequate and thus presents an unacceptable risk to the manufacturer's business. As a result, the manufacturer may change suppliers. If this Court does not further clarify "group boycott" in deciding the present case, it is easy to anticipate a flurry of lawsuits by disappointed suppliers who allege that their replacement constitutes a group boycott by their manufacturer and the new supplier, if not a group boycott by all of the manufacturers and suppliers in AIAG.

But the antitrust laws, and group boycott law in particular, should not affect a manufacturer's ability to decide to buy parts only from suppliers with computer systems adequate to support the manufacturer's production process. The decision below may well make such a choice into the basis of a long-running and expensive, if ultimately unsuccessful, antitrust

action, unless this Court reverses that decision in a way that forecloses future misapplications of *Klor's* or *General Motors*.

III. FACIALLY DEFECTIVE ANTITRUST ACTIONS ARE APPROPRIATELY DISMISSED UNDER RULE 12(b)(6)

Antitrust plaintiffs bear not only a burden of proof, but a burden of coherence in alleging conduct that constitutes a violation of the antitrust laws. "[A] district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed." *Associated General Contractors* v. *California State Council of Carpenters*, 459 U.S. 519, 528 n.17 (1983). Plaintiffs are not entitled to try to extort a settlement through burdensome discovery when the strictures of Rule 11 prevent them from alleging facts that might support an antitrust claim.

The district court appropriately disposed of the complaint in this case, which attempted to transform respondent's dissatisfaction with petitioners' choice of a different service supplier into an antitrust claim by "endeavor[ing] to relitigate much of the conduct underlying the break up of old AT&T." J.A. 51. The Second Circuit recognized that "Discon cannot succeed" on the Section 1 theories it advanced. Pet. App. 10a. But rather than taking the complaint on its own terms and affirming the dismissal, the Second Circuit labored to fashion a new theory from old precedent to keep this litigation in the courts.

This Court should explicitly endorse the district court's efficient disposition of this meritless claim. In an earlier antitrust case the Court encouraged "[d]istrict courts [to] be especially alert to identify frivolous claims brought to extort nuisance settlements." *Reiter* v. *Sonotone*, 442 U.S. 330, 342 (1979). It is wholly appropriate for district courts evaluating antitrust lawsuits to "exercise sound discretion and use the tools available" to prevent harassment of business and misuse of the courts (*ibid.*) by requiring that the pleaded facts — not merely the general allegations of subjective intent that the

Second Circuit found largely sufficient (Pet. App. 11a) — add up to a coherent and sustainable theory of an antitrust violation, particularly when competitors rather than consumers are the plaintiffs. See *Dial A Car, Inc.* v. *Transportation, Inc.*, 82 F.3d 484, 487-488 (D.C. Cir. 1996) (Edwards, C.J.); *Interface Group, Inc.* v. *Massachusetts Port Authority*, 816 F.2d 9, 12 (1st Cir. 1987) (Breyer, J.) (affirming dismissal because "facts alleged" could not "make out the * * * injury to the competitive process necessary to show" an antitrust violation). "It is * * * important to find ways to *reduce* the attractiveness of antitrust as a method of raising rivals' costs." Easterbrook, *supra*, 63 TEX. L. REV. at 34 (emphasis added). The Second Circuit instead increased the attractiveness of antitrust litigation as a substitute for competition in the marketplace. This Court should take the opportunity presented here to endorse intelligent judicial scrutiny of antitrust complaints, with prompt dismissal of those that cannot survive on the facts pleaded.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

PHILLIP D. BRADY
MARK SLYWYNSKY
American Automobile Manufacturers Association
1401 H Street, N.W.
Suite 900
Washington, D.C. 20005

STEPHEN M. SHAPIRO
ROY T. ENGLERT, JR.
Counsel of Record
DONALD M. FALK
MICHAEL E. LACKEY, JR.
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

Counsel for Amicus Curiae

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